INSURANCE COMPETITIVE PRICING ACT OF 1993

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

H.R. 9

TO MODIFY THE ANTITRUST EXEMPTION APPLICABLE TO THE BUSINESS OF INSURANCE

JULY 29, 1993

Serial No. 13

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE
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INSURANCE COMPETITIVE PRICING ACT OF 1993

THURSDAY, JULY 29, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE JUDICIARY,
SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2141, Rayburn House Office Building, Hon. Jack Brooks (chairman of the subcommittee) presiding.

Present: Representatives Jack Brooks, John Conyers, Jr., Mike Synar, Dan Glickman, Howard L. Berman, Robert C. Scott, David Mann, Melvin L. Watt, Hamilton Fish, Jr., Elton Gallegly, Charles T. Canady, Bob Inglis, Bob Goodlatte, and Carlos J. Moorhead.

Subcommittee staff present: Cynthia W. Meadow, counsel; George P. Slover, assistant counsel; Perry Apelbaum, assistant counsel; Carrie Bedwell, assistant counsel; Catherine S. Cash, research assistant; Suzanne Young, secretary; full committee staff present: Jonathan R. Yarowsky, general counsel; Alan F. Coffey, Jr.; minority chief counsel; and Mary Margaret Adams, intern.

OPENING STATEMENT OF CHAIRMAN BROOKS

Mr. BROOKS. This morning the subcommittee will hear testimony on the bill H.R. 9, the Insurance Competitive Pricing Act of 1993.

The insurance industry's antitrust exemption continues to unleash passionate arguments on all sides, which the committee has listened to for three Congresses. But more important, we have paid close attention to the reasoning behind the arguments.

The insurance industry touches every corner of the American economy, reaches into every pocketbook. Yet this all-important industry has been exempt from the antitrust laws since the McCarran-Ferguson Act of 1945 was passed. At that time most in Congress believed that they had only agreed to a short 3-year moratorium before the antitrust laws would apply with full force. But the devil was in the details, and the conference report made a little change that went virtually unnoticed: It transformed the 3-year moratorium into a permanent exemption.

While State oversight of insurance has generally proved to be useful, it has certainly not been infallible in all lines of business. For this reason, I have always contended that Congress should defer to State regulation where it is effective and accountable. But where it is not, there must be some competitive safety net to safeguard consumers. This is the crux of the legislation.

As we approach the 21st century, blanket antitrust exemptions can no longer be justified—if they ever could. Over the past several years, many thousands, if not millions, of American consumers have found themselves unable to buy affordable insurance to run their businesses, protect their homes and automobiles, and protect their health. And it seems that every time there is a major accident or natural disaster large enough to make the news, some in the insurance industry are right there talking about raising prices.

For anyone who has read H.R. 9, it should be obvious—at times, painfully obvious, to me—that the legislation is a compromise bill, drafted to avoid the more radical changes strongly advocated by some. I have been gratified in recent months that in addition to consumer groups and State enforcement officials, segments of the insurance industry itself have begun to recognize that balanced reform can be achieved when proper care is given to maintaining and expanding new markets and acknowledging that certain insurance practices are necessary and even procompetitive.

We all appreciate that the insurance industry provides invaluable services to the American public. But the challenges facing the American free enterprise system can no longer permit a critical sector of the economy to be totally immune from both competitive forces and effective regulation.

My sense is that new developments in the economy and in the Nation's leadership auger well for this Congress to pass needed modification of McCarran-Ferguson so that both we and the industry can finally move on to other matters. It is high time.

[The bill, H.R. 9, follows:]

I

103D CONGRESS
1ST SESSION

H. R. 9

To modify the antitrust exemption applicable to the business of insurance.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 5, 1993

Mr. BROOKS introduced the following bill; which was referred to the Committee on the Judiciary

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A BILL

To modify the antitrust exemption applicable to the business of insurance.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Insurance Competitive Pricing Act of 1993".

SEC. 2. AMENDMENTS.

Section 2 of the Act of March 9, 1945 (59 Stat. 34; 15 U.S.C. 1012), commonly known as the McCarran-Ferguson Act, is amended—

(1) in subsection (b)—

(A) by striking ": *Provided,* That after June 30, 1948," and inserting ", except that",

(B) by inserting "section 5 of" after "Clayton Act, and",

(C) by inserting "as such section 5 relates to monopolies, attempts to monopolize, and unlawful restraints of trade," after "Commission Act, as amended,", and

(D) by striking "that such business" and all that follows through "law." and inserting the following:

"that—

"(1) such business is not regulated by State law; or

"(2) the conduct of a person engaged in such business involves—

"(A) price fixing;

"(B) allocating with a competitor a geographical area in which, or persons to whom, insurance will be offered for sale;

"(C) unlawfully tying the sale or purchase of—

"(i) one type of insurance to the sale or purchase of another type of insurance; or

"(ii) any type of insurance to the sale or purchase of any other service or product; or

"(D) monopolizing, or attempting to monopolize, any part of the business of insurance.", and

(2) by adding at the end the following:

"(c) The conduct referred to in subsection (b)(2) shall not include making a contract, or engaging in a combination or conspiracy—

"(1) to collect, compile, or disseminate historical loss data;

"(2) to determine a loss development factor applicable to historical loss data; or

"(3) to perform actuarial services if such contract, combination, or conspiracy does not involve a restraint of trade.

"(d) During the transition period, the conduct referred to in subsection (b)(2) shall not include making a contract, or engaging in a combination or conspiracy, to determine a trend factor.

"(e) For purposes of this section—

"(1) the term 'historical loss data' means information respecting claims paid, or reserves held for

claims reported, by any person engaged in the business of insurance;

"(2) the term 'loss development factor' means an adjustment to be made to reserves held for losses incurred for claims reported by any person engaged in the business of insurance, for the purpose of bringing such reserves to an ultimate paid basis;

"(3) the term 'transition period' means—

"(A) the 4-year period beginning on the effective date of the Insurance Competitive Pricing Act of 1993, in the case of a person—

"(i) that wrote insurance having an aggregate amount of annual premiums less than $20,000,000; and

"(ii) not more than 50 percent of which was owned or controlled by another person engaged in the business of insurance;

in the then most recently ended 1-year period; or

"(B) the 2-year period beginning on such effective date, in the case of any person to which subparagraph (A) does not apply; and

"(4) the term 'trend factor' means an adjustment to be made to losses incurred for claims re-

ported by any person engaged in the business of insurance, to reflect a change in inflation or any other change in the estimated loss costs incurred by persons engaged in the business of insurance.".

SEC. 3. EFFECTIVE DATE.

This Act shall take effect 1 year after the date of the enactment of this Act.

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Mr. BROOKS. Mr. Fish, do you have an opening statement?

The gentleman from New York.

Mr. FISH. Thank you, Mr. Chairman.

At the outset I want to welcome all the witnesses who will appear here today. I see some familiar faces as well as some new faces, and I appreciate the assistance of everyone in these deliberations.

In particular I want to welcome Mrs. Anne Bingaman, the new head of the Antitrust Division in the Justice Department. I hope this will be the first of many appearances that you will make before this subcommittee.

My views on the antitrust protections contained in the McCarran-Ferguson Act should be well known, as they are well documented. This particular antitrust exemption makes economic common sense to me because it reflects the marketplace realities that are faced by the insurance industry and the property/casualty segment of that industry in particular.

McCarran-Ferguson allows insurers to safely share statistical information without fear of antitrust liabilities. The industrywide distribution of actuarial data and trending information results in the more accurate and precise pricing of the various lines of insurance. Consequently, prices are lower and more accurate than they otherwise would be. That does not sound to me like an anticompetitive result or an anticonsumer result.

I am very concerned that the enactment of H.R. 9 will have serious adverse economic consequences. First, the State action defense under antitrust law will be jeopardized.

Second, dual regulation involving both State governments and Federal agencies would be established.

Third, some of the procompetitive cooperative activities that I referred to will be called into question.

Fourth, the legislative language before us creates uncertainty and this terminology will prompt years of litigation.

Finally, this legislation could have an adverse effect on the solvency of small and regional insurers.

If the language of H.R. 9 remains unchanged, the amount of actuarial data and other information that is now available to these companies would be significantly reduced. Simply put, they are going to have less information on which to judge the risks that they insure. And how can we expect these businesses to lower the price of the various lines of insurance if they have less information about the actual risk involved?

In the wake of the S&L crisis, Mr. Chairman, Congress needs to be very careful and certain that there is no adverse impact on the solvency and financial stability of insurance companies.

I thank you, Mr. Chairman, for recognizing me. I look forward to the hearing and the testimony of the witnesses here this morning.

I know Mr. Moorhead expected to be with us this morning. I ask unanimous consent that his statement be made part of the record.

Mr. BROOKS. Without objection.

[The prepared statements of Mr. Moorhead, Mr. Synar, and Mr. Berman follow:]

H.R. 9

STATEMENT OF HONORABLE CARLOS J. MOORHEAD
ECONOMIC AND COMMERCIAL LAW SUBCOMMITTEE
JULY 29, 1993

THANK YOU, MR. CHAIRMAN.

AT THE OUTSET, I WOULD NOTE THAT I HAVE VOTED AGAINST THIS LEGISLATION ON A NUMBER OF PREVIOUS OCCASIONS. I DID SO, BECAUSE I BELIEVE THAT THERE ARE VALID ECONOMIC AND POLICY REASONS THAT JUSTIFY THE ANTITRUST IMMUNITY GRANTED TO THE "BUSINESS OF INSURANCE" BY THE MCCARRAN-FERGUSON ACT.

THE JOINT COLLECTION AND SHARING OF ACTUARIAL INFORMATION ENHANCES COMPETITION IN THIS HIGHLY COMPETITIVE INDUSTRY. THE COLLECTIVE ACTIVITIES PROTECTED BY MCCARRAN-FERGUSON PROVIDE LIABILITY INSURERS WITH THE STATISTICAL INFORMATION THEY NEED TO CARRY ON THEIR BUSINESS.

THIS STATISTICAL INFORMATION -- HISTORICAL LOSS DATA, LOSS DEVELOPMENT AND TRENDING INFORMATION -- ENABLES INSURERS OF ALL SIZES AND TYPES TO MORE ACCURATELY ANTICIPATE POTENTIAL RISKS AND CLAIMS. SMALL COMPANIES, IN PARTICULAR, ARE FEARFUL THAT THEIR ACCESS TO THIS ESSENTIAL DATA WILL BE JEOPARDIZED IF H.R. 9 IS ENACTED.

H.R. 9 WOULD SUBJECT INSURERS TO A SERIES OF PER SE ANTITRUST VIOLATIONS THAT WOULD APPLY IN ADDITION TO ANY EXISTING STATE REGULATION. FURTHER, THE BILL ALSO AUTHORIZES THE FEDERAL TRADE COMMISSION TO INVESTIGATE THE TRADE PRACTICES OF THE INSURANCE INDUSTRY. THIS BILL IS THE BEGINNING OF DUAL REGULATION.

FURTHERMORE, THE STATE ACTION DEFENSE WILL BE JEOPARDIZED. TO MEET THE "ACTIVE STATE SUPERVISION" REQUIREMENT OF ANTITRUST CASE LAW, APPROXIMATELY

HALF THE STATES WOULD HAVE TO CHANGE THEIR LAWS. IRONICALLY, THIS WOULD MEAN REVERTING BACK TO LESS FLEXIBLE AND MORE RESTRICTIVE RATING SYSTEMS.

A MAJOR PART OF MY CONCERN IS THAT THIS LEGISLATION MEANS HIGHER PRICES AND LESS CHOICE FOR CONSUMERS. IT WILL CREATE CONFUSION AND UNCERTAINTY IN THE INSURANCE INDUSTRY AND AMONG CONSUMERS. IT WILL PROMPT YEARS OF LITIGATION. WHAT WILL HAPPEN IN THE MEANTIME? NO ONE REALLY KNOWS. BUT ONE THING WE DO KNOW FOR SURE -- LIABILITY INSURANCE WILL NOT MAGICALLY BECOME MORE AVAILABLE OR MORE AFFORDABLE AS A RESULT OF THE PASSAGE OF H.R. 9. IN FACT, THE EXACT OPPOSITE WILL LIKELY OCCUR.

I LOOK FORWARD TO THE TESTIMONY THIS MORNING BUT, ONCE AGAIN, I HAVE TO SAY THE PROPONENTS OF H.R. 9 BEAR A VERY HEAVY BURDEN OF PROOF.

MIKE SYNAR
2D DISTRICT, OKLAHOMA

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**OPENING STATEMENT FOR CONGRESSMAN MIKE SYNAR (D-OK)
BEFORE THE HOUSE JUDICIARY SUBCOMMITTEE
ON ECONOMIC AND COMMERCIAL LAW HEARING ON H.R. 9
THE "INSURANCE COMPETITIVE PRICING ACT OF 1993"
July 29, 1993**

This morning the Subcommittee once again examines the antitrust exemption currently enjoyed by our nation's insurance industry. This is the sixth consecutive Congress that this Subcommittee has examined the exemption and my position on this issue is well established.

From my perspective, there is no rationalization for the favored status of the insurance industry and no argument I have yet been presented with which justifies the industry's broad antitrust exemption in its current form. Further, I believe that the burden of proof for retaining the exemption rests with the industry and not with the supporters of change.

In general there are three reasons for my position. First, the antitrust laws have long served a valuable role in providing a marketplace discipline for many services and they are appropriate for the business of insurance. Second, the premise for establishment of the exemption no longer exists in today's economy. Third, I don't believe the application of the antitrust laws to the insurance industry will have the dire effect predicted by industry analysts.

Today we will hear from a broad range of viewpoints on H.R. 9. As always, I will be carefully considering the arguments of those who oppose this legislation. The insurance industry has made progress on a number of competition issues during the time Congress has had McCarran-Ferguson reform under consideration and I am always vigilant for evidence that this trend continues.

I am looking forward to today's testimony and I expect that with your leadership, Mr. Chairman, we will resolve this issue this Congress.

STATEMENT OF HON. HOWARD L. BERMAN
ON H.R. 9
JULY 29, 1993

Mr. Chairman: I am delighted to join you today in strong support of your efforts to pass H.R. 9.

This legislation is long overdue, and believe me, I am not unaware of the historical record on this subject.

In 1944, the U.S. Supreme Court issued an opinion which overturned long-settled law, creating havoc in the insurance industry and casting doubt on the authority of the states to tax the industry. This nation could ill afford the resulting confusion at a time when our undivided attention and energies needed to be directed toward the urgent task of winning World War II.

And so it was that President Roosevelt asked the Congress to enact a two-year moratorium on the result reached in the S.E. Underwriters case. But the antitrust exemption in McCarran-Ferguson -- as interpreted by the insurance industry, I might add -- is what Congress produced, and Americans have been living with the consequences ever since.

Collusive price-fixing, product tying --- we know the litany of abuses, and I presume that fresh evidence will be presented today of anticompetitive.conduct which we would not tolerate in any other industry.

I am particularly taken with the saga of Rick Nelson: his efforts to bring down the cost of insurance for consumers, and the price he has paid for those efforts. I am happy to see that Mr. Nelson is with us again today because the story he has to tell is an instructive one.

I have a story of my own to tell as well. Consistency is not the hobgoblin of the collective consciousness of this industry, When the 19th century Supreme Court in the Paul decision held that an insurance contract is not an instrument of commerce, relegating the regulation of the industry to the states, the industry embarked on an effort to seek federal regulation in order to avoid a multiplicity of regulatory schemes. But slowly the industry realized that their advantage lay precisely in that multiplicity because it meant no effective regulation at all. Leave it to the states, they now say.

But on the other hand, on a related issue dear to my heart, the industry strongly supports the action of the Supreme Court in the Pilot Life case stripping the states of the authority to provide remedies to Americans whose insurance claims have been unfairly denied. Yet they just as strenuously oppose my efforts to enact an effective federal remedy.

Are we wrong to conclude that this is an industry that simply opposes effective remedies and regulation, whether at the state or federal level? I don't think so.

Six years ago, a prominent industry lobbyist said of our former chairman's support for McCarran Ferguson reform, "Rodino is getting old. He's not feeling well, and he doesn't have the stomach for the kind of knock-down, drag-em-out fight..." that taking on McCarran Ferguson would require.

Putting aside the inaccuracy and venality of that comment, Mr. Chairman, I think you do quite well in the intestinal fortitude department, and I am happy to join you here today in your efforts to enact H.R. 9.

Mr. BROOKS. This morning I am asking the witnesses to appear at the witness table in panels to testify on H.R. 9, the Insurance Competitive Pricing Act of 1993. To save a little time, I would request that all the witnesses summarize their statements in 5 minutes, if they can, and after the witnesses have completed their statements the subcommittee will address questions to all of the panel. All the prepared statements will be made a part of the record, every pristine word. We are not going to chip it in stone. We are going to reproduce it, though, in type.

Without objection, the hearing record will remain open to receive written testimony from persons who have requested their statements be made a part of the printed record.

Our first witness is Anne K. Bingaman, Assistant Attorney General, Antitrust Division. I am pleased to be able to tell everyone here, she is real. She is just what the doctor ordered for the Antitrust Division, and not a moment too soon. She is a tried and tested litigator who knows antitrust law, is well-versed in the theoretical debates of antitrust, but has the good sense to move beyond theory to the practical necessity of making this country more competitive.

She is from the best frontier stock, homesteaders in Oklahoma, and with the rest of those Okies, she moved west to New Mexico to start a solo practice in antitrust and other areas of the law, successfully taking on the nuclear dumping industry, among others. She has seen the courtroom from both the plaintiffs' table and from the defendants'. She is now in the process of revitalizing morale and vigor throughout the Antitrust Division.

It is a pleasure to welcome you before the subcommittee. Proceed, Madam Secretary.

STATEMENT OF HON. ANNE K. BINGAMAN, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Ms. BINGAMAN. Mr. Chairman, I am deeply grateful for your generous words. They mean very much to me personally, and I thank you.

Let me say how pleased I am to be here today on behalf of the Department of Justice to present the views of the Department on proposals to amend the McCarran-Ferguson Act so as to narrow the scope of the antitrust immunity it now affords to the business of insurance.

The Department of Justice believes the time has come to act on such legislation, and the Department supports the objectives of the subcommittee in this regard.

Mr. Chairman, my written statement is in the record, and I will avoid a lengthy recitation of the statement. Let me just summarize briefly, as the chairman requested, the views of the Department.

We do not express a view today on H.R. 9 itself, or specific provisions of it. As the chairman knows, I have been in office a month, and I have not had the time, frankly, to delve into every single provision of H.R. 9 and the background of it. We are, however, as a Division, and I, personally, am aware of the broad exemption afforded the business of insurance and what an anomalous situation that is in American business today.

Most businesses in this country are subjected to the rigors of competition. Those rigors are tough, they are demanding, and they are very difficult. But we committed this Nation on a course 100 years ago to make competition the watchword of this country and to have our businesses live up to it, so as to deliver the benefits of competition to our consumers in the form of lower prices, improved products, and greater availability of products.

And, Mr. Chairman, it seems to us that those very fundamental principles, almost a Magna Carta, if you want to call it that, of American economic life, should apply to the business of insurance as well.

Mr. Chairman, let me make it clear, however, that the Department does not here propose absolute repeal across the board of McCarran-Ferguson. What we propose is that the exemptions in McCarran-Ferguson be narrowed, be limited, and that carefully crafted and more tailored safe harbors be given where the committee finds those are appropriate to certain joint activities that may be unique to the insurance industry. We propose that the broad exemption now afforded by McCarran-Ferguson be limited and the safe harbors specifically delineated.

Mr. Chairman, the general position we are taking here for reform of McCarran-Ferguson and limiting the exemption to carefully crafted safe harbors is not a radical posture. It was supported as long ago as 1979 by the National Commission Report on Antitrust Laws and Procedures that one of my predecessors, Mr. John Shenefield, chaired and authored. And there is a very distinguished and succinct report in 20 pages or so from 1979, 14 years ago, that goes through many of the issues and finds many of the same things the committee, I think, might find upon further consideration.

The ABA commission to improve the liability insurance system, in 1989, just 4 years ago, also came out with a strong recommendation after a study of limiting the McCarran-Ferguson exemption. Neither of these groups has been for outright repeal. Both have been for crafting a more narrowly limited exemption.

I might also mention to the chairman, as I am sure you are aware, that another of my predecessors, Mr. Rick Rule, testified in 1987, and walked right up to the line of recommending reform of McCarran-Ferguson.

So, Mr. Chairman, the position the Department advocates today is mainstream antitrust competition policy. We are for thoughtful, careful reform.

We commend the chairman for his long years of work on this issue. And we look forward to working with this committee and with the Congress to come up with legislation that will meet the legitimate needs of the industry but will inject competition into the insurance business in this country.

Mr. BROOKS. Thank you very much.

[The prepared statement of Ms. Bingaman follows:]

Prepared Statement of Hon. Anne K. Bingaman, Assistant Attorney General, Antitrust Division, Department of Justice

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Department of Justice on proposals to amend the McCarran-Ferguson Act so as to narrow the scope of the antitrust immunity that it affords to the business of insurance. The Department believes that the time has come to act on such legislation, and supports the objectives of the Subcommittee in this regard.

Prior to 1944, regulation of the business of insurance was seen as the exclusive province of the states. In that year, the Supreme Court held in United States v. South-Eastern Underwriters Association 1/ that the insurance business was within the regulatory power of Congress under the Commerce Clause and thus was subject to the antitrust laws. This decision was perceived to threaten state authority to regulate and tax the business of insurance. The McCarran-Ferguson Act was designed to return the legal climate to that which existed prior to South-Eastern Underwriters by specifically delegating to the states the authority to continue to regulate and tax the business of insurance. It also created a broad antitrust exemption based on state regulation. This antitrust exemption applies where three basic requirements are met: (1) the

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1/ 322 U.S. 533.

challenged activity must be part of the "business of insurance"; (2) that business must be regulated by state law; and (3) the activity must not constitute boycott, coercion, or intimidation.

Repeal or reform of the broad antitrust exemption currently enjoyed by the business of insurance has been a perenniel subject of interest. In 1977, a Justice Department study concluded that the insurance industry could function competitively without the protection of the McCarran-Ferguson Act. The National Commission for the Review of Antitrust Laws and Procedures recommended in 1979 that the broad exemption in the Act be replaced by narrowly drawn legislation adopted to affirm the lawfulness of a limited number of collective activities under the antitrust laws. The 1989 report of the American Bar Association Commission to Improve the Liability Insurance System contained a generally similar recommendation. This Subcommittee and other bodies of Congress have held several hearings on the McCarran-Ferguson exemption over the years, and during the last session the full Committee reported favorably legislation that would replace the current exemption with a narrower one affording continued protection to certain procompetitive activities. The pros and cons, as well as the particulars, of legislative reform of the McCarran-Ferguson antitrust exemption have thus been thoroughly and carefully debated. The Department believes that the time has come to enact such legislation.

The Department is generally opposed to exemptions from the antitrust laws, whether they be industry-specific or general, in the absence of a strong showing of compelling need. The antitrust laws protect and promote the nation's fundamental national policy of competition. Exceptions from that policy should be and fortunately are relatively rare. Those who advocate the creation of a new antitrust exemption, or the preservation of a longstanding exemption such as that contained in the McCarran-Ferguson Act, rightfully bear a heavy burden in justifying the exemption.

In considering any alleged need for an antitrust exemption, the flexible nature of the antitrust laws as interpreted in such recent cases as General Dynamics, 2/ GTE Sylvania, 3/ Broadcast Music, 4/ and Northwest Wholesale Stationers, 5/ must be recognized. Allegations that particular procompetitive behavior would violate the antitrust laws and thus should be exempted from their application can fail to take account of the

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2/ United States v. General Dynamics Corp., 415 U.S. 486 (1974).

3/ Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

4/ Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979).

5/ Northwest Wholesale Stationers, Inc. v. Pacific Stationary and Printing Co., 472 U.S. 284 (1985).

economically sound competitive analysis that is used today to carefully circumscribe per se rules and fully analyze other conduct under the rule of reason. Congress has occasionally recognized a need for clarification of a proper antitrust standard or adjustment of antitrust remedies, as it did earlier this year in passing the National Cooperative Production Amendments of 1993, but the flexibility of the antitrust laws and their crucial importance to the economy argue strongly against antitrust exemptions that are not clearly and convincingly justified.

There are strong indications that possible justifications for the broad insurance antitrust exemption in the McCarran-Ferguson Act when it was enacted in 1945 are no longer valid today. To the extent that the exemption was designed to enable the states to continue to regulate the business of insurance, it is no longer necessary. The "state action" defense, which had been announced by the Supreme Court in Parker v. Brown 6/ in 1943 but was undeveloped in 1945 when the McCarran-Ferguson Act was enacted, has now been the subject of many Supreme Court opinions. This defense allows a state effectively to immunize what the antitrust laws otherwise may proscribe by clearly articulating and affirmatively expressing

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6/ 317 U.S. 341.

a policy to displace competition and by actively supervising any private conduct that might be involved.

Moreover, the application of the antitrust laws to potentially procompetitive collective activity has become far more sophisticated during the nearly 50 years since the McCarran-Ferguson Act was enacted. Some forms of joint activity that might have been prohibited under earlier, more restrictive doctrines are now clearly permissible, or at very least analyzed under a rule of reason that takes appropriate account of the circumstances and efficient operation of a particular industry. Thus, there is far less reason for concern that overly restrictive antitrust rulings would impair the insurance industry's efficiency. And, as I will discuss in more detail in a moment, to the extent that a case can be made that uncertainty as to the application of the antitrust laws may deter particular procompetitive activity even if, in the long run, such conduct would be vindicated, legislation could be enacted that would afford continued protection to carefully defined conduct that is considered necessary or appropriate to the operation of the insurance industry.

Against what I believe to be less than convincing justifications for continuance of the current broad antitrust exemption for the business of insurance are some significant potential benefits from legislation that would narrow it. First, reform of this exemption is consistent with the normal

presumption that an industry functions more efficiently and in the interests of consumers without antitrust exemptions that permit potentially anticompetitive conduct. State regulation of collective insurer conduct that affects rates or terms of coverage is simply not a good substitute for the disciplines of a competitive marketplace. This may be particularly true where states are forced to devote more of their limited regulatory resources to guarding against discrimination or protecting solvency than to ensuring competitively priced options for consumers. Second, some regulatory goals, such as guarding against discrimination or protecting solvency, appear to be obtainable without the broad antitrust exemption that is currently in place. If convincing arguments are made that a particular regulatory goal cannot be furthered without collective conduct that is or might be considered unlawful under the antitrust laws, such conduct could be protected by a special exception in legislation that narrowed the current broad exemption.

The matter of antitrust uncertainty that I discussed above and possible arguments regarding the need for certain collective conduct to promote state regulatory goals go more, I believe, to the form and precise content of legislation to reform the current antitrust exemption for the business of insurance than to its overall desirability. I see no reason why these concerns could not be accommodated by the legislative process.

It may be argued that the development of antitrust law takes time and occasionally may take a wrong turn. Uncertainty as to how collective insurer conduct will fare under the antitrust laws is thus argued potentially to inhibit procompetitive activities. I give some credence to this argument, but believe that legislation that contains carefully drawn safe harbors would be an adequate and appropriate response. I would, however, caution against accepting the uncertainty argument too willingly and safe harboring activities that may be anticompetitive, at least in some contexts. First, the courts are in my view capable of making and likely to make the right decisions regarding any conduct in the business of insurance that is subjected to antitrust challenge. Second, the current antitrust exemption in the McCarran-Ferguson Act has proven to be highly resistant to change, and I suspect that the decisions Congress makes on what will continue to be protected by the Act will be in effect for a long time. Thus, I believe that there should be a high degree of confidence in the worthiness of any specific antitrust protection that Congress decides to continue. And, with respect to promoting state regulatory goals, we should recognize that those goals may vary from state to state and can also be promoted through the exercise of state action to exempt particular conduct from antitrust scrutiny.

In sum, the Department supports replacement of the current broad exemption for the business of insurance with more carefully crafted protection for activities that are demonstrably potentially procompetitive and efficiency-enhancing. Such legislation must, of course, be consistent with the Administration's forthcoming health care reform proposal. We believe that McCarran-Ferguson reform legislation can accommodate the interests of those who support such reform--including the Department--as well as those who have expressed concern that reform would have to permit insurance companies large and small to engage in activities that would both benefit consumers and allow the industry to prosper.

Mr. Chairman, this concludes my prepared statement. I would be happy to address any questions that you or the other members of the Subcommittee may have.

Mr. BROOKS. The second witness is Mr. Laurel A. Price, deputy attorney general for the State of New Jersey. He is here to represent the National Association of Attorneys General. He chaired its Multistate Task Force on Antitrust and argued for the States before the Supreme Court in the *Hartford* case.

Mr. Price.

STATEMENT OF HON. LAUREL A. PRICE, DEPUTY ATTORNEY GENERAL, NEW JERSEY DIVISION OF CRIMINAL JUSTICE, AND CHAIR, MULTISTATE ANTITRUST TASK FORCE, NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

Mr. PRICE. Thank you, Mr. Chairman, members of the committee. I would like to thank you particularly for the opportunity to address the need for the rational application of the antitrust laws to the insurance industry.

I am the most recent in a long line of witnesses on behalf of the National Association of Attorneys General, both attorneys general and staff, who have come before this committee to urge the outright repeal of the McCarran-Ferguson Act.

We also recognize that anything which narrows the scope of the exemption currently enjoyed by the industry is beneficial to consumers. We, therefore, also encourage the committee to consider favorably measures like H.R. 9, which would narrow and rationalize the application of the antitrust laws to an industry which has enjoyed too long a range of unbridled and effectively undisciplined commercial behavior. The insurance industry is motivated primarily by its own perceptions of its needs rather than any perception of significant dedication to the needs of either the consumers or the greater public at large.

There are two things I would like to point out specifically. The first is that the State action doctrine as it currently exists in the law is a very precise means by which to determine when the public interest is being served by the determinations of public bodies rather than private parties. The test that is articulated to determine when effective State regulation of interstate commerce can coexist with the antitrust laws is a very straightforward two-part test.

It requires, first, some affirmative articulation by the State of the necessity to supplant competition. Then, second, the State must have an effective means of regulating and supervising that departure from the competitive environment mandated by that regulatory system.

We think that the precision that is represented by that test better serves the consuming public than a test such as currently applied under McCarran, which is one of almost benign neglect in many instances, or what one of my friends once referred to as magic wand regulation. Once the wand has passed over your head, you are golden.

But the thing I want to address most particularly is the issue which Ms. Bingaman addressed and which the bill itself addresses, and that is the issue of safe harbors. While NAAG's official position is one of favoring outright repeal without the definition of safe harbors, we are mindful that the necessities of the industry and the certainty in the application of the antitrust law to the industry may in fact necessitate the existence of such safe harbors.

In the crafting of those safe harbors, however, we would urge you to look to the specific regulatory experience of the States, and to draft your safe harbors in ways that accommodate the differing policies and regulatory decisions made by the States.

I specifically would note with respect to the issue of loss development, which is one of the specific safe harbors identified in subsection C, that some States—New Jersey in particular with respect to the auto industry—have taken a different position. It has taken the position that the reporting of historical data and the industry's need for it ceases at the point that the data being reported is in fact historical and the result of actual occurrences.

It does not in the implementing regulations, for instance, permit the estimation of future unknown values which involve important underwriting and business discretion decisions which create the variability and dynamics in product pricing normally found in any industry in a competitive environment.

Accordingly, I would recommend to the committee that in crafting the safe harbors, that a limiting introductory clause be added to subsection C, and that that subsection relating to safe harbors should be modified by saying that those safe harbors will exist except when the State regulatory law is to the contrary.

And with that suggestion, I would close by urging the committee to adopt H.R. 9 with the amendment that I propose.

Thank you.

Mr. BROOKS. Thank you very much.

[The prepared statement of Mr. Price follows:]

STATEMENT

of

LAUREL A. PRICE

Deputy Attorney General

New Jersey Division of Criminal Justice

Chair, National Association of Attorneys General

Multistate Antitrust Task Force

before the

Subcommittee on Economic and Commercial Law

of the

COMMITTEE OF THE JUDICIARY

HOUSE OF REPRESENTATIVES

on

H.R. 9

A BILL TO MODIFY THE ANTITRUST EXEMPTION

APPLICABLE TO THE BUSINESS OF INSURANCE

July 29, 1993

Mr. Chairman and Members of the Subcommittee:

Thank you Mr. Chairman and members of the subcommittee for this opportunity to address the need for the rational application of the antitrust laws to the insurance industry. This committee under the leadership of Representative Brooks has spent a significant amount of time during the last several Congresses probing the unique antitrust exemption enjoyed by the insurance industry. The National Association of Attorneys General and many Attorneys General have also spent significant time and effort investigating and litigating the issues involved in this

industry's antitrust status. Like H.R. 9, the Attorneys General have consistently concluded since 1986 that insurance consumers would be better off if the antitrust exemption for the insurance industry contained in the McCarran-Ferguson Act were eliminated or, failing that, significantly curtailed.[1]

We were gratified in late June of this year when the Supreme Court ruled that our pending suits against various insurers, reinsurers and others would be remanded to the lower federal courts in San Francisco.[2] Those suits, brought within the confines of the current law, address specific abuses that allegedly occurred during the mid-1980s. Because those matters are still under adjudication in the courts, I will not comment on them beyond noting that there were a range of abuses identified in the investigation leading up to the filing of those cases that are not, and could not be, addressed because of the unique antitrust shelter currently enjoyed by the insurance industry. Assistant Attorney General George Sampson of New York detailed some of these additional abuses for this Committee in his June, 1991 testimony on a predecessor version of the present bill.

H.R. 9 seeks to modify the insurance industry's antitrust exemption. The Attorneys General have consistently urged its outright repeal. Recognizing that meaningful modifications, such

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[1] See the attached copy of NAAG Resolution adopted in June, 1986.

[2] Hartford Fire Ins. Co., Inc., et al v. California, et al, Docket Nos. 91-1111 & 1128 (U.S. June 28, 1993).

as those contained in H.R. 9, will also benefit consumers, we have also supported those measures as well.

Since the McCarran-Ferguson Act was adopted almost fifty years ago, there have been significant changes in the antitrust laws and in the technology that can be brought to bear on the insurance industry. It is those changes that warrant our attention in the analysis of the public policy considerations attending the proper application of the antitrust laws to the insurance industry.

At the time of the passage of the McCarran Act the so-called "state action" doctrine spawned by Parker v. Brown, 317 U.S. 347 (1943), was in its infancy. The Congress could not with complete confidence anticipate that the doctrine would eventually develop into the flexible doctrine of accommodation that now permits continued state economic regulation of interstate commerce where the state affirmatively establishes a policy of regulation and effectively supervises its implementation and operation.[3] The current state action test represents relative precision when compared to the more generalized test under the McCarran Act noted by the Judiciary Committee's October 6, 1992 report on the predecessor of the present bill.[4]

Unlike the concern in the mid-1940s, we now know that antitrust and effective state regulation can and does comfortably

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[3] See California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980), and cases following.

[4] H.R. Rep. No. 1036, 102d Cong., 2nd Sess. at 25-28 (1992).

coexist. The greater precision of the state action test gives the public greater confidence that a particular permitted restraint of trade is actually the product of some over-riding public purpose. Under McCarran, it is frequently difficult to tell where mere private greed or convenience ends and over-riding public purpose begins. The elimination of the McCarran-Ferguson Act in favor of the state action test will reduce, if not eliminate, that uncertainty and, correspondingly, increase the public's confidence that it is being treated fairly.

Technology also has evolved in ways that counsel stricter antitrust scrutiny for the insurance industry. I have in my brief case this morning a seven and one half pound computer that represents more deliverable computing and analytical power for any given period of time than that possessed by even the most sophisticated insurance company at the time of the adoption of the McCarran Act. Accordingly, as data analysis becomes more readily available at more cost effective levels, one must but wonder whether the needed levels of coordination appropriate for myriad clerks in green eye shades working with mountains of ledger cards are precisely the same as they are in the modern data processing era. I am sure that this Committee either has or will hear it said that the needs of modern technology require more rather than less coordination. I suspect it to be otherwise. However, the States have created a living laboratory out there in the broader world of insurance regulation. This

Committee may draw empirical evidence to resolve various differing claims from that regulatory experience.

California adopted Proposition 103. New Jersey adopt the Fair Automobile Insurance Reform Act of 1990. Texas has substantially revamped its insurance regulatory laws in recent years. One of the features common to each of those regulatory schemes has been enhanced antitrust exposure coupled with a recognition of the industry's need for aggregated historical claims data of sufficient scope and consistency to be credible for product pricing purposes. There are differences between these regulatory regimes regarding the extent to which the so-called safe harbors for data collection would permit the collective estimation of future unknown values--regardless of whether the operation at hand was described as trending or loss development.

I note these differences in permitted data collection and reporting requirements neither for the purpose of endorsing nor for the purpose of condemning any particular safe harbor provision for data collection operations. Rather, I cite them for two different purposes. First, I suggest that there may be available comparative data from which the Committee could draw empirical evidence. In that way you would be less dependent on particular witness's philosophical predilections or the quality of his or her anecdotes.

Second, and more importantly, the States have been in recent years experimenting with different combinations of regulation,

competition and antitrust exposure for the insurance industry. A particular state may reach a conclusion that market factors should be the primary regulator of industry performance. To that end, it would desire the maximum possible application of the antitrust laws to assure and guarantee the efficacy of that competition. H.R. 9, like the McCarran Act itself, affirms the primacy of state regulation for insurance within broad limits. Assume, for example, that a given state decides that loss development should be subjected to the scrutiny of its antitrust laws. Assume further that its antitrust laws are substantively patterned on the federal antitrust laws. Under those circumstances, no discernible public purpose is served by continuing safe harbor treatment for that conduct under federal law. Accordingly, I would personally urge the Committee to consider amending subsection (c) appearing at page 3, line 8 of H.R. 9 by the addition of a clause reading, "(c) In the absence state law to the contrary, the conduct . . . ."

There is no reason why federal law should create safe harbors for antitrust liability that are more expansive than those mandated by state law. Similarly, there is no discernible public purpose served by creating the anomaly of liability for conduct under state antitrust law where that same conduct is exempt from federal antitrust liability by reason of a federal statute designed to buttress the integrity of the state regulatory regime. Where the state has determined that particular conduct in the insurance industry should be subject to antitrust liability, there is no reason why the antitrust laws of the United States should not also be available to reinforce that determination.

NATIONAL ASSOCIATION OF ATTORNEYS GENERAL

Summer Meeting
Seattle, Washington
June 9-12, 1986

RESOLUTION I

REPEALING THE INSURANCE INDUSTRY'S EXEMPTION FROM THE ANTITRUST LAWS

WHEREAS, The Sherman Act, the Clayton Act, and decisional law prescribe the appropriate standards of conduct for competing businesses and for individual firms acquiring and exercising market power in the United States; and

WHEREAS, those laws prohibit activities in restraint of trade that have repeatedly been shown to be harmful to the economy and injurious to consumers; and

WHEREAS, in 1944, the Supreme Court determined, in United States v. South-Eastern Underwriters Association, 322 U.S. 533, that the business of insurance constitutes commerce within the scope of the antitrust laws; and

WHEREAS, in 1945, Congress, apprehensive about the effect of South-Eastern Underwriters on the powers of states to tax and regulate insurance, adopted the McCarran-Ferguson Act (15 U.S.C. sections 1011-1015), granting the insurance industry broad exemption from most provisions of the Sherman and Clayton Acts, including the proscriptions against such anticompetitive practices as price-fixing, agreements not to compete, monopolization, mergers of dominant firms, tying agreements, and a wide range of other conduct that is unlawful for nearly every firm outside the insurance industry; and

WHEREAS, subsequent developments in antitrust law, particularly evolution of the state-action doctrine, have made it clear that nothing in the Sherman and Clayton Acts would hinder the exercise of traditional state powers of taxation and regulation, including price-regulation, making the antitrust immunity of the McCarran-Ferguson Act unnecessary for the purposes that originally motivated Congress to enact it; and

WHEREAS, it is also clear that nothing in the antitrust laws prohibits insurers from sharing information on losses in order to price their product, or from engaging in reinsurance and other risk-sharing arrangements common to the industry, making the antitrust immunity of the McCarran-Ferguson Act unnecessary to the legitimate needs of the insurance industry; and

WHEREAS, the insurance industry is critical to the national economy, with Americans paying over $140 billion per year in premiums on property/casualty insurance alone, and with insurance being a necessity for many enterprises; and

WHEREAS, serious questions have been raised about the current crisis in liability insurance and whether it may have been fostered by the industry's antitrust exemption;

NOW, THEREFORE, BE IT RESOLVED, that the National Association of Attorneys General, reaffirming its commitment to the historic right of the states to regulate and to tax insurance and its commitment to the importance of the antitrust laws to free and competitive markets, urges the Congress of the United States to repeal the special immunity from the antitrust laws granted to the insurance industry and to subject insurance companies to the rules of the competitive marketplace applicable to other firms; and

BE IT **FURTHER RESOLVED**, that the Association authorizes its Executive Director and General Counsel to make these views known to the Congress, the Administration, and other interested parties.

Mr. BROOKS. Before turning to a couple of questions to the Assistant Attorney General and the Deputy Attorney General, I want to note a significant turning point we have reached in this hearing. Not only have we witnessed today the return of the Justice Department to its strong position against exemptions from our Nation's competition statutes, but we also have a letter from the lawyer who preceded Ms. Bingaman as Republican chief of the Antitrust Division, Mr. James F. Rill, an outstanding antitrust lawyer who unfortunately has clients in San Francisco who are paying him and he couldn't volunteer to come and testify. When you are in the private industry, you are in it.

But I would like to insert his letter at this point into the record and read an excerpt or two from it. He says, "Dear Chairman Brooks, Your decision to conduct the forthcoming hearings on the McCarran exemption is a very positive, timely, and significant step toward concrete action in assessing the continued need for that exemption in its present form. As you know, the Antitrust Division conducted a thorough review of the McCarran exemption during my tenure as Assistant Attorney General and, in fact, chaired a working group of the Economic Policy Council on the subject. We did not find any empirical support for any claim that appropriate application of the antitrust laws to the insurance industry would operate seriously to the detriment of that industry."

He went on to say that "There are, of course, a number of questions which need to be resolved including the appropriate scope for any safe harbors and a transition period that will facilitate compliance by the insurance industry with the antitrust laws. In the final analysis, however, the great preponderance of American industry has complied with the antitrust laws and not suffered by that compliance. Vigorous competition has encouraged efficiency and innovation and made U.S. firms better able to compete in domestic and world markets. Your continued focus on the McCarran exemption and ultimate action to bring the issue to a fair resolution is in my opinion very much consistent with the national objectives of the antitrust laws."

And we have copies of that for everybody.

[The letter from Mr. Rill follows:]

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JUDICIARY COMMITTEE

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July 28, 1993

The Honorable Jack Brooks
Chairman
Judiciary Committee
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, D.C. 20515-6216

Dear Chairman Brooks:

Your decision to conduct the forthcoming hearings on the McCarran exemption is a very positive, timely, and significant step toward concrete action in assessing the continuing need for that exemption in its present form. As you know, the Antitrust Division conducted a thorough review of the McCarran exemption during my tenure as Assistant Attorney General and, in fact, chaired a working group of the Economic Policy Council on the subject. We did not find any empirical support for any claim that appropriate application of the antitrust laws to the insurance industry would operate seriously to the detriment of the industry. I was pleased to note that Anne Bingaman stated in her confirmation hearings that those seeking exemptions under the antitrust laws would have to carry a heavy burden to support their position. This statement is consistent, of course, with the statement of William P. Barr with specific reference to the McCarran-Ferguson provision during his confirmation hearings.

There are, of course, a number of questions which need to be resolved including the appropriate scope for any safe harbors and a transition period that will facilitate compliance by the insurance industry with the antitrust laws. In the final analysis, however, the great

preponderance of American industry has complied with the antitrust laws and not suffered by that compliance. Vigorous competition has encouraged efficiency and innovation and made U.S. firms better able to compete in domestic and world markets. Your continued focus on the McCarran exemption and ultimate action to bring the issue to a fair resolution is in my opinion very much consistent with the national objectives of the antitrust laws.

Sincerely,

James F. Rill

JFR:msd

Mr. BROOKS. Ms. Bingaman, how do you respond to the argument that the antitrust laws are not needed in the insurance industry because the industry is already so competitive?

Ms. BINGAMAN. Mr. Chairman, I would say this. The industry may in fact be competitive in segments today, but there may be segments in which it is not competitive. And if McCarran-Ferguson is modified so as to inject more competition and new elements of competition into the industry, I think that can only be beneficial.

Secondly, the fact that the industry is competitive today does not necessarily mean it will stay that way for the next 50 years. McCarran-Ferguson has been with us 50 years now. There are undoubtedly great changes ahead for the American economy in the next 50 years as there have been for the last 50. We have relied on competition as the guiding principle to shape business decisions in this country for over 100 years.

And it seems to me that the best course for the future, to chart the long-range future for this industry and for all the rest in the American economy who are now subject to competition, is to narrow McCarran-Ferguson and inject competition into this industry with carefully crafted safe harbors. I emphasize the need for them.

Mr. BROOKS. Mr. Price, anything you want to add to that?

Mr. PRICE. I think I would raise a question about the competitiveness of the industry in this regard. It is competitive to the extent that there are a large number of companies seeking to sell similar products to the same people. Whether they are effectively competing in the same way that other industries compete, I have serious questions.

Because of the atmosphere created by McCarran and the lockstep within which the industry moves, the kind of innovation and diversification of product and services that one would normally expect simply hasn't developed. So you have in effect competition occurring within a very narrow band rather than the broad-based environment of competition which would better serve the public interest.

There is considerable debate in the literature over whether the large number of companies that exist within various segments of the industry in fact represent the product of healthy competition or whether, in fact, they represent the result of an excessive surplus generated by a noncompetitive environment shared by a large number of companies who would not be economically viable in a true competitive environment; and that the existence of those companies, therefore, may represent a significant cost to society.

Mr. BROOKS. Ms. Bingaman, there are some who contend that the antitrust laws work for some industries but are not needed for others. Do you believe that small- or mid-sized insurance companies would disappear with the careful scaling back of the McCarran-Ferguson antitrust exemption?

Ms. BINGAMAN. Mr. Chairman, that is a critically important question. That is unquestionably a major issue before this committee, and it was certainly a factor with us in reaching the views we did.

We met with a group which presented to us very strongly—a number of them are here today and I am sure you will hear from

them later—the view that this would in fact cause the demise of small- to medium-size companies.

Mr. Chairman, it is our belief that a properly drafted revision of McCarran-Ferguson, with the kinds of provisions that are in the current H.R. 9, which allow a 2- to 4-year phase-in for trending, and allow companies a chance to get used to the new regime, to learn how to operate within it before they are on their own, so to speak, with their own actuaries, if that is the form the bill takes, is protection against that kind of problem.

Secondly, I would simply point out that the collection of historical loss data has traditionally, under standard antitrust analysis, been allowed. So these small- to medium-sized businesses absolutely will have the benefit of this mass of historical data which unquestionably is important to come up with future costs.

So, Mr. Chairman, I believe that properly done and carefully written, a bill that narrows the McCarran-Ferguson exemption need not harm small companies in any way—and I would very fervently hope that it absolutely did not, and I think the committee should make every effort and we will do the same. Small business is the lifeblood of this country; entrepreneurship is crucial to the country. We cannot take steps that will harm that.

At the same time, competition is crucial to the country also. And so the balance has to be struck and has to be worked on. But it is our view that it is possible.

Mr. BROOKS. I want you to know that I do not consider this my strongest antitrust statement. You know, with this bill the insurance industry gets about 14,000 exemptions. The cut was easy in the first place—just a straight repeal. Not to mention that this bill has been delayed for years.

You know, I have been in the State legislature, and I have known State insurance commissioners. They are wonderful people. They have an even deeper regard for insurance companies than we do. They have a personal affection for them that is very extensive.

Every time I read this bill I kind of feel bad. It is so easy. And they have been complaining about it.

I kept thinking, let's write them a bill that will shake their teeth, get after them—just abolish the whole exemption, and have the issue out, bring all the other industries in, have a good knockdown, drag-out fight. We could have one in this committee and have one on the floor. It would be fun.

But I am glad that you agree that a nice, carefully scaled-down compromise would be useful, would be nice. Maybe the industry will do better. We can guide them along the way and encourage them.

And you, sir, the way you talk about insurance companies, you have already been to Atlanta, Jacksonville, and Hartford? You've seen all those small companies doing fine in those big buildings? Either they have small companies with big buildings or they have got an awful lot of big companies, if you have noticed the structure there. In Omaha, you might drop by there.

Mr. PRICE. I have actually been by the one in Oklahoma, sir.

Mr. BROOKS. I have one more question for you. Since my legislation would defer to the States, if State oversight met the standards of the State action doctrine, legitimately proved, and since that doc-

trine is utilized every day by States to immunize other industries from antitrust suits, would it be difficult to apply that doctrine to this industry?

Mr. PRICE. I don't believe it would be at all difficult, Your Honor. I mean, sir, I am sorry. I spend too much time in court.

The application of the State doctrine to the insurance industry would not require any great adjustment in the doctrine itself. Indeed, it would require no adjustment in the doctrine, because the doctrine is predicated on the notion that the State has made the determination and has effectively supervised it.

It doesn't look to the underlying merits of the regulatory decision as such. Therefore, the application is simply and reasonably straightforward. The concerns that the industry have raised to me regarding the intersection between antitrust and the industry have not related so much to the details of the application of State action, but whether the antitrust laws themselves are sufficiently flexible to accommodate the commercial necessities of the insurance industry. I have seen no substantial degree of new rigidity interjected into that body of law in recent years which would further those fears.

Mr. BROOKS. Mr. Price, one other thing. What does the recent Supreme Court holding in the *Hartford Insurance* case, which you worked on, tell you about whether consumers can depend solely on the so-called boycott exemption to protect them from competitive practices?

Mr. PRICE. I think the easy answer to that is, it is too early to tell. Justice Scalia has redefined the analysis to some extent, although the test he articulated is one which is reasonably straightforward and easy to apply.

The problem, if any, in the opinion has nothing to do with the test; it has rather to do with some assumptions of fact relied upon differently by different parts of the court, which will have to be sorted out on a full record.

The more important question, though, is the one that preexisted the court's opinion, and that is whether the discipline of the antitrust laws should be left to a narrow band of what can be shoehorned into the doctrine of boycotts.

Mr. BROOKS. Thank you very much.

Mr. Fish, the gentleman from New York.

Mr. FISH. Thank you, Mr. Chairman.

Ms. Bingaman, on a number of previous occasions the Department of Justice has written this committee to express its opposition to H.R. 9 and its predecessor bills. These statements express concern about the possible "deterrent effect" that H.R. 9 would have on procompetitive activity among insurers.

These documents also reflect a serious concern about the impact of H.R. 9 on the availability of the State action doctrine.

It is, of course, argued that we don't need the McCarran-Ferguson Act because we have the State action defense. This morning Mr. Price has given us a clear restatement of the two-pronged Midcal test, which I accept. But the question is, will the regulatory scheme in the States meet that test, or are there such pronounced differences among the regulatory schemes that many won't?

So on April 10, 1987, when Charles Rule was the Assistant Attorney General, I wrote him, and in his response of September 10, 1987, he summarizes my question. He says, "You requested the Department of Justice undertake a survey of existing state insurance law and regulation to determine the likely extent to which insurance industry practices will be protected by the "state action" doctrine as applied under the federal antitrust laws if the statutory antitrust exception of McCarran-Ferguson Act were repealed."

Mr. Rule then says, "[I]t appears that some present insurance industry practices would be protected in some states by the state action doctrine while others would not if the McCarran-Ferguson Act were repealed."

We have a letter addressed to the chairman with a copy to me dated November 18, 1991, that was written at the time that Assistant Attorney General James Rill was in office. Mr. Rill's name was mentioned just a few minutes ago.

I will just read some highlighted sections from that letter. "While the Department generally endorses the review of existing antitrust exemption under the McCarran-Ferguson Act, it opposes H.R. 9."

On page 2 the letter states, "The Department is concerned that H.R. 9 may, because of its structure and language, have an unwarranted deterrent effect on appropriate collective activity among insurers."

The last four or five lines on page 2, "Private parties could well be deterred from engaging in such conduct for fear that courts would treat the conduct as illegal. Taken literally, however, these categories encompass some conduct that is not automatically unlawful under the antitrust laws and may in some instances be procompetitive. In sum, H.R. 9 creates ambiguities, both as to the legal effect and meaning of the specified categories, that could deter procompetitive conduct."

Reading again on page 3, halfway down the page, "The conduct that would be covered by the safe harbors of H.R. 9 does not include several activities that have appeared in other legislative proposals to repeal or reform the antitrust exemption in the McCarran-Ferguson Act."

And the last line of that paragraph, "Many of these activities may be conducted jointly in a manner that is procompetitive."

Turning to page 4, "The Department is concerned that the language of H.R. 9 is ambiguous as to whether the bill would effectively preempt state regulation that would constitute state action exempt from the operation of antitrust laws under established judicial precedent."

And the last paragraph on page 4, it begins "We believe attempts to deal with the state action preemption issue by means of legislative history are inadequate."

[The text of the two letters follows:]

APPENDIX 3

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

November 18, 1991

Honorable Jack Brooks
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter presents the views of the Department of Justice on H.R. 9, the "Insurance Competitive Pricing Act of 1991." This bill would amend the McCarran-Ferguson Act to limit substantially the antitrust exemption provided by that Act for the business of insurance to the extent that such business is regulated by state law. While the Department generally endorses review of the existing antitrust exemption under the McCarran-Ferguson Act, it opposes H.R. 9.

Existing Law and H.R. 9

The McCarran-Ferguson Act currently provides a general antitrust exemption for the business of insurance to the extent such business is regulated by state law. This exemption is very broad: it covers any activity other than boycott, coercion, or intimidation. H.R. 9 would narrow this exemption substantially. The bill would continue to apply the antitrust laws (including section 5 of the Federal Trade Commission Act) to the business of insurance to the extent such business is not regulated by state law. It would also apply those laws--notwithstanding the existence of state regulation--to certain specified categories of conduct: price fixing, allocation of geographic territories or customers among competitors, unlawful tying arrangements and monopolization or attempted monopolization. 1/ The bill would continue to exempt certain collective insurer activities: collecting, compiling

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1/ See proposed new section 2(b)(2) of the McCarran-Ferguson Act.

and disseminating historical loss data, determining a loss development factor applicable to such data, and performing actuarial services where they do not involve a restraint of trade. 2/ In effect, these excluded activities would remain protected from antitrust scrutiny by state regulation of the business of insurance.

Concerns with H.R. 9

1. Possible Effects on Procompetitive Insurer Activities. The exemption for the business of insurance in the McCarran-Ferguson Act is very broad and extends to activity that, but for the exemption, would violate the antitrust laws. Nevertheless, the exemption also protects certain collective activity among insurers that may be necessary or appropriate in the interest of competition and consumers. Thus, a proper approach to McCarran-Ferguson reform must strike an appropriate balance between narrowing the exemption so as to subject potentially anticompetitive conduct to the antitrust laws while facilitating efficient, procompetitive collective action. H.R. 9 attempts to achieve that balance by maintaining the general exemption but specifying certain categories of conduct that will be subject to the antitrust laws. The Department is concerned that H.R. 9 may, because of its structure and language, have an unwarranted deterrent effect on appropriate collective activity among insurers.

While the bill does not state that its specified categories of conduct are illegal, some of the specified categories--price fixing, allocating territories or customers among competitors, and monopolizing or attempting to monopolize--are couched in terms often used to describe antitrust violations. Private parties could well be deterred from engaging in such conduct for fear that courts would treat the conduct as illegal. Taken literally, however, these categories encompass some conduct that is not automatically unlawful under the antitrust laws and may in some instances be procompetitive. 3/ In sum, H.R. 9

2/ See proposed new section 2(c).

3/ For example, vertical agreements between insurers and their agents regarding rates, or agreements among the participants in a joint underwriting pool regarding the pool's rates, might be described literally as "price fixing" but might in certain instances be entirely appropriate. Similarly, allocation of risks among participants in a residual market pool could be described literally as horizontal market allocation, while traditional antitrust analysis might or might not condemn such

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creates ambiguities, both as to the legal effect and meaning of the specified categories, that could deter procompetitive conduct.

2. "Safe Harbors." H.R. 9 attempts to deal with the above concerns by excluding certain specific collective activities from the general categories of conduct that it subjects to the antitrust laws. Thus, the bill would create a "safe harbor" for these excluded activities from antitrust scrutiny as long as the business of insurance is regulated under state law.

The excluded activities in H.R. 9 include (1) collecting, compiling or disseminating historical loss data, (2) determining a loss development factor applicable to historical loss data, and (3) performing actuarial services if such does not involve a restraint of trade. 4/

The conduct that would be covered by the safe harbors of H.R. 9 does not include several activities that have appeared in other legislative proposals to repeal or reform the antitrust exemption in the McCarran-Ferguson Act. Those activities include the preparation, dissemination and filing of policy forms and classifications, participation in joint underwriting or pools or residual market mechanisms, research and inspections for purposes of risk classification, and collection, compilation, and dissemination of information relating to fraudulent claims or practices. Many of these activities may be conducted jointly in a manner that is procompetitive.

3. State Action. Under the "state action" doctrine, restraints on competition (in any industry, not just insurance) are exempt from the operation of the antitrust laws if they are clearly articulated and effectively expressed as state policy

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3/ Continued

conduct in an individual case. The inclusion of "tying" among the categories, even with the qualifying word "unlawfully," also presents problems because tying arrangements are not always anticompetitive and may be efficient in certain circumstances.

4/ The safe harbor for actuarial services appears illusory, because proof that actuarial services "restrain trade"--proof of an antitrust violation--would defeat the state regulation-based exemption that it purports to provide.

and the anticompetitive conduct is actively supervised by the state itself. 5/

The Department is concerned that the language of H.R. 9 is ambiguous as to whether the bill would effectively preempt state regulation that would constitute state action exempt from the operation of the antitrust laws under established judicial precedent. H.R. 9 is identical to H.R. 1663, which was reported favorably by the Committee on the Judiciary last year. The Committee's report addressed the ambiguity regarding the scope of state action protection in the section-by-section analysis accompanying the bill. 6/ The report states that the bill would establish two tiers for the application of the antitrust laws with respect to state action. The first tier simply restates what is already the case under the existing Act--that in the absence of any state regulation, the antitrust laws fully apply. The second tier deals with the common situation where there is something more than a complete absence of regulation, ranging from minimal (e.g., automatic approval of rates) to "effective" regulation (extensive supervision under an explicit authorization). The report states that "effective state regulation" would trigger immunity under the state action doctrine in all instances, just as it does today in other industries subject to the antitrust laws. However, where there is some regulation, but less than effective regulation, the report states that the antitrust laws would apply fully to conduct within the four specified categories.

We believe attempts to deal with the state action/ preemption issue by means of legislative history are inadequate. Courts are not required to consult legislative histories in all instances, and will do so only if there is ambiguity on the face of the statute. While we believe such ambiguity exists, it is not so apparent as to ensure that the intent of Congress will necessarily be discerned by courts by resort to the legislative history. Thus, we believe that any ambiguity with respect to the application of the state action doctrine to the business of insurance must be eliminated from the bill itself.

5/ See, e.g., Patrick v. Burget, 486 U.S. 94 (1988). "State action" is legally distinguished from "state regulation," a looser concept that only provides an antitrust exemption to the business of insurance under the McCarran-Ferguson Act.

6/ House Report 101-796, October 27, 1990.

The Office of Management and Budget has advised us that there is no objection to the submission of this report to Congress.

Sincerely,

W. Lee Rawls
Assistant Attorney General

cc: Honorable Hamilton Fish, Jr.

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

September 10, 1987

Honorable Hamilton Fish, Jr.
Vice Chairman
Subcommittee on Monopolies and
Commercial Law
House of Representatives
Washington, D.C. 20515-6216

Dear Mr. Vice Chairman:

This letter further responds to your request of April 10, 1987. You requested that the Department of Justice undertake a survey of existing state insurance law and regulation to determine the likely extent to which insurance industry practices would be protected by the "state action" doctrine as applied under the federal antitrust laws if the statutory antitrust exemption in the McCarran-Ferguson Act were repealed. During my March 4, 1987 testimony before the Subcommittee, we agreed that uncertainty as to this issue, and the likely reaction to that uncertainty by state legislatures and regulators as well as insurance companies, were important factors for Congress to consider in its current deliberations on repeal or reform of McCarran-Ferguson.

I regret the delay in responding to your request. As our staffs have discussed, the Department faced difficulties in responding due to the breadth of the issues and our reluctance to state hypothetical legal conclusions that might impede the Department's future antitrust enforcement efforts.

Whether current insurance industry practices--particularly collective activities among competing insurers directly related to rates--would be protected by the "state action" defense is an extremely broad question. State statutes bear most directly on this question, but regulation is also relevant--the absence of explicit statutory authorization of concerted activities has been held not to defeat a state action defense where a properly authorized state regulatory commission used its discretion to encourage such activities. Each of the 50 states regulates insurance in its own way. Such regulation varies

significantly, not only across state lines, but also across the many personal and commercial lines of insurance in the property/casualty and life and health areas. The history, purpose, and extent of such regulation, as well as the extent to which a given practice in a given line in a given state that might be subject to antitrust challenge is mandated or authorized by such regulation, would all be relevant in determining its status under the state action doctrine.

Complicating the question is the fact that the breadth of the state action doctrine has yet to be fully delimited. As articulated by the Supreme Court in several recent decisions, to constitute "state action," private conduct must be (1) undertaken pursuant to a clearly articulated state policy to displace competition, and (2) be actively supervised by the state. The Court's decision in the Southern Motor Carriers case 1/ makes clear that private conduct need not be compelled by state law or regulation to satisfy the first prong of the test. That decision does not, however, definitively bridge the gap between state "neutrality" regarding a regulated practice, which has been held inadequate to support a state action claim, 2/ and affirmative, yet non-compulsory state policy that was held to be adequate in the regulatory context at issue in Southern Motor Carriers.

Further, with regard to the second prong of the state action test, what does or would constitute such supervision in a given context is not yet clear. As indicated by the Department's recently-filed brief in the Patrick v. Burget case, 3/ the Department believes that even with respect to such potentially procompetitive and otherwise beneficial conduct as professional peer review, adequate active supervision by the state must be in place before antitrust immunity exists. Because regulatory oversight of insurance company practices appears to vary substantially, resolution of the active supervision issue across the many insurance lines in the several states is particularly problematic.

1/ Southern Motor Carriers Rate Conference v. United States, 471 U.S. 48 (1985).

2/ Cantor v. Detroit Edison Co., 428 U.S. 579 (1976).

3/ Patrick v. Burget, petition for cert. filed, Sup. Ct. No. 86-1145 (recommending that certiorari be granted and that the Court of Appeals' decision be reversed on the active supervision issue).

I am sure you will also understand the inherent reluctance of the Department to address hypothetical legal questions that could bear heavily on potential antitrust enforcement activities. Faced with a potential "state action" claim in one of its investigations, the Department is able to undertake a full factual and legal inquiry and address such a claim specifically rather than in general terms. Particularly for this reason, I must emphasize that our views on the McCarran-Ferguson/state action question are only tentative and must not be taken to bind any future Department enforcement activity in a specific context.

Notwithstanding these inherent difficulties in considering the extent of state action uncertainty that would follow McCarran-Ferguson reform or repeal, we have surveyed knowledgeable individuals in several states with substantially differing insurance regulatory schemes. On the basis of those interviews, it appears that some present insurance industry practices would be protected in some states by the state action doctrine while others would not if the McCarran-Ferguson Act were repealed. Some practices could be protected only if more liberal interpretations of the Southern Motor Carriers decision are adopted in evolving case law. If Southern Motor Carriers is read more narrowly, these practices could be subject to antitrust challenge. It is noteworthy that some industry practices that are currently protected by McCarran-Ferguson and might not be protected by the state action doctrine do not really need antitrust protection, because they do not have anticompetitive effects and indeed may be comparable to practices common in other industries that generally have not been thought to raise serious antitrust concerns. As you know, the Department will not support repeal of the McCarran-Ferguson Act unless it is clear in the legislation that legitimate practices are legal under the antitrust laws. A more particularized account of our interviews and current thinking follows.

Rate Regulation

Many who strongly support McCarran-Ferguson repeal or reform cite collective ratemaking activities, including the activities of the rate bureaus, as warranting antitrust-oriented reform. Roughly comparable activities in the intrastate motor vehicle transportation industry were the focus of the state action issue in Southern Motor Carriers. The Supreme Court's state action inquiry in that case concerned primarily the manner and extent of state regulation of rates. We made similar inquiries during our interviews of knowledgeable state insurance regulatory officials.

In one state, Massachusetts, we understand that insurance rates in most lines essentially are set by the state insurance department. That department receives requests, information, and advice from insurance companies and private rate bureaus, but itself sets the final rates. Companies are required to adhere to the state-made rates. It would appear that this process would be largely protected from antitrust challenge by the state action doctrine.

Many states utilize a less stringent form of rate regulation, generally referred to as "prior approval," that appears comparable at least in significant respects to the regulatory schemes at issue in Southern Motor Carriers. Insurance companies, or rate bureaus acting on their behalf, calculate desired rates and apply for permission to use them. These rates, however, may not be implemented without prior regulatory approval, a process that can take months and includes public disclosure of the requested rate. Prior approval states apparently have differing statutes and regulations regarding the role of rate bureaus and the types of information the bureaus may disseminate to their members. Further, the degree of the state regulators' involvement in setting the final rates appears to vary. As indicated above, these are factors that could influence the state action analysis of particular rate-setting practices. The prior approval feature of such regulation would be important to the argument that the "active supervision" prong of the state action test is satisfied.

Many other states have various forms of the so-called "open competition" rating system. These include "file-and-use," "use-and-file," and "flex" systems. Companies in "file-and-use" and "use-and-file" states do not need prior approval from the state insurance department before implementing their rates, although they must file their rates either in advance of or simultaneously with implementation, and the state insurance department has a given period within which to question or suspend the new rates. "Flex" rating is a newly developed hybrid system that permits increases or decreases in rates within a fixed percentage without prior regulatory approval. Prior approval is required for changes of greater magnitude. We understand that New York, for example, uses "flex" rating in many lines of insurance. Rate increases or decreases of 10 to 25 percent, depending on the line of insurance, apparently may be instituted without the state's prior approval. We believe that the state action status of collective rate making in "open competition" states would be more questionable than in "prior approval" states. On the other hand, from a policy perspective, the Department prefers such pro-competition, anti-government-intervention systems over

all the alternatives except that employed by Illinois (see below).

The role of rate bureaus also varies among "open competition" states. We understand that for many lines of insurance in New York many smaller companies use, with fairly minor adjustments, rates formulated by a rate bureau. Companies whose own experience is too limited to provide a reliable data base apparently must use the bureau rate, while larger companies may obtain recommended rates from a bureau but must justify any rate they request on the basis of their own experience. Each company is required to file its rates independently, although we are told that if the insurance department seeks justification for a newly filed rate, a smaller company must rely on the rate bureau, which has the necessary data, to supply the supporting information. The state insurance department is aware of the rate bureau's activities and believes the bureau's services to be important to the viability of many of the smaller insurance companies. Whether a state had "affirmatively expressed" and "clearly articulated" a policy of encouraging the operation of rate bureaus under such a scheme would depend in part on how broadly or narrowly the Southern Motor Carriers holding was applied. Whether such state involvement in rating would constitute "active supervision" sufficient to satisfy the second prong of the state action test is also open to question.

We are advised that Illinois stands alone among the states in permitting insurance companies to set their rates for most lines of insurance with essentially no state supervision other than enforcement, through periodic examinations, of statutory antidiscrimination provisions. It appears that there is no clear articulation of a state policy to displace competition in insurance rating and that rating apparently is not actively supervised by the state. Thus, collective ratemaking activities in such a state would be unlikely to derive antitrust immunity from the state action doctrine.

In short, our survey disclosed substantial differences in the way insurance rating is regulated by the several states. These differences could be most significant to the determination whether private collective practices affecting rates were immunized by the state action doctrine.

Regulation of Other Collective Activities

We also inquired into state regulation of other joint insurance company or rate bureau practices, such as drafting of policy terms and risk classifications. Many states, including California and New York, have antidiscrimination requirements

that reportedly are vigorously enforced by the state insurance department. Where a state has an affirmatively expressed and clearly articulated policy to regulate policy terms and risk classifications, where policy terms and risk classifications are actively supervised by the state, and where joint action is permitted and even encouraged by the state as a means of promoting compliance, a strong argument exists that collective activities in these areas would be protected from antitrust scrutiny by the state action doctrine.

In several states various voluntary and involuntary programs have been developed to address problems in the availability or affordability of various types of commercial insurance. We are informed that these programs can be quite successful in providing needed coverage where shortages have developed. These programs have varying origins: some involuntary programs are created directly by legislation, while some are created at the regulator's discretion pursuant to a statutory grant of authority. Reportedly, voluntary programs are often created at the instigation of state regulators as a prompt and effective alternative to more formal, more permanent, involuntary programs. Certainly many of the voluntary programs operate with the regulators' blessing. With many of these arrangements, however, there apparently is no affirmatively expressed or clearly articulated state policy to displace competition, especially where the program is informal and voluntary and where the market failure that gave rise to the need for these joint efforts and the joint solution are expected to be temporary. Moreover, the activities of many of these groups apparently are not always actively supervised in some states. In fact, we have been told that some state regulators, while keeping informed, otherwise intentionally remain somewhat aloof from the daily operation of these programs, hoping insofar as is possible to give free rein to market forces. In other states regulators are active participants in the workings of voluntary programs. It seems that at least some of these programs would not qualify for antitrust immunity under the state action doctrine. It should be noted, of course, that they generally may not be anticompetitive and might not face antitrust liability even in the absence of McCarran-Ferguson protection. Some such programs, however, might present difficult antitrust questions, or at least appear to present these questions, raising the possibility of long and expensive litigation even if the ultimate result was a finding of no antitrust liability.

I hope our brief, necessarily general survey and comment on the likely state action status of collective activities among insurers will be of use to you in your consideration of the issues that are raised by the proposals to reform or repeal the

McCarran-Ferguson Act. The concern you expressed in your letter of April 10, 1987--that the state action defense would not automatically substitute for the immunity provided by the McCarran-Ferguson Act--appears to us to be an accurate one. It should be noted, of course, that such substitutability is not the premise of the current proposals for McCarran-Ferguson legislation. As I indicated in my statement to the Subcommittee, a key intention of such proposals is to apply presumably more restrictive state action standards to the business of insurance before immunizing collective activities from the operation of the antitrust laws. Whether the benefits of doing so would outweigh the potential costs I described in my statement is the key question before Congress.

Thank you for your interest in the Department's views on these issues, and continuing support of effective, procompetitive antitrust laws and enforcement.

Sincerely,

Charles F. Rule
Assistant Attorney General

Mr. BROOKS. Would the gentleman yield?

Mr. FISH. I haven't asked my question yet.

Mr. BROOKS. I understand. I was going to say that Jim Rill did not seem to be adamantly opposed to the concept when he worked for the Republicans. And the letter sounds more like it was written by Boyden Gray.

Mr. FISH. I am reading what the Department said at that time and what they identified as problems. I think the word "problems" is very appropriate.

My question for the witness is, are these problems and concerns about H.R. 9 ones that you also share?

Ms. BINGAMAN. Congressman Fish, I haven't seen that particular letter. I have reviewed a number of things from the Department history, but I missed that particular thing. But I can respond generally to you based on what I understood from your summary.

I think that the concerns set out there could be addressed in drafting legislation that expressly set forth the collective activities which this committee found appropriate. If legislative history is believed not to be an adequate protection, put it in the bill. That seems to me to be the answer.

And it is also the answer, I might add, to concerns about the extent of State regulation. In other words, problems with—the first part of your question went to problems with how far the State action doctrine extended, how much supervision there was, and so forth. I think that was the gist of your concern. So it seems to me that an appropriately drafted bill that is quite complete as to the activities which are protected and very clear would solve both of those concerns.

Mr. FISH. I agree with you that a lot of drafting—I think the point I was getting at—from the letter that I was reading—was that there are serious defects in the language of H.R. 9. Certainly, more drafting would be a good idea.

The letter that I was quoting from most extensively was dated November 18, 1991, when Mr. Rill was the Assistant Attorney General. And I refer that letter to you. I would be glad to provide you with a copy if you would like it, because I would like to know whether the Antitrust Division still sees the same problems with the specific language contained in H.R. 9. The bill is identical this year to what it was when commented on by your predecessor.

So let me move on. I would like to discuss with you the relationship you see between President Clinton's health care reform efforts and this debate over McCarran-Ferguson. The health care reform proposals often call for health insurers to act together in dealing with certain high risks. So, if McCarran is repealed or significantly modified, couldn't that call into question any type of collective action and interfere with the cost containment goals of health care reform?

Put another way, won't health insurers be resistant to taking collective actions called for by health reform proposals if the McCarran protections are gone?

Ms. BINGAMAN. As I understand what you are speaking of, it is what we term residual market mechanisms, to be sure that high-risk individuals, for whatever reason, whether it is a poor driving record or health record or whatever, are able to receive insurance.

Mr. FISH. That is one example, yes.

Ms. BINGAMAN. Under standard antitrust analysis, if there is pooling in order to offer a product which would not otherwise be available because no one company felt it could take the risk, and a pool is set up in order to allow the product to be offered, that is considered procompetitive, because it in fact creates a new product which would not be available to those consumers otherwise.

So I think the analysis put in effect by the courts today looks to the economic impact of this joint agreement. Twenty-five years ago courts might have looked at any agreement as per se illegal, and concluded they shouldn't talk to each other. Courts today are much more sophisticated. They apply economic analysis and they look to the actual economic impact.

So my understanding is that the kind of residual market mechanism in the health field you are addressing or any other field would be permitted under standard antitrust law. But I would state, I personally could not see a problem if the committee considered that desirable with writing something in expressly covering such residual market mechanisms if it makes a new product available that otherwise is not.

Mr. FISH. I thank you for that analysis.

It is my view that the provisions are not sufficient with respect to pooling. And the safe harbor language in H.R. 9 is simply not adequate on this point. I just ask you if you would address that.

At the time he was Assistant Attorney General, Rick Rule felt that the State action defense would not automatically be available in approximately half the States because of their particular form of insurance regulation, and therefore we should not assume that the State action defense would automatically substitute for McCarran immunity.

So we have to look at all types of regulation. We should not assume that this defense will be an automatic substitute for McCarran. How do you suggest we address this particular problem in the legislation?

Ms. BINGAMAN. Well, Congressman Fish, I think the point is you wouldn't want State regulation to automatically step up and cover everything McCarran did, or there would be no point to this effort, if that were just automatic. I think the idea of reform is to inject competition into this system in the pricing of insurance and in other items. So I think you would not want State regulation to automatically cover any gap.

As to the specific regulations in effect in each of the States right now, I honestly can't speak to that. I am not familiar with it.

Mr. FISH. I am just concerned that some of the exchanges that are going on now would not be protected in the future.

If I have time for one more question, I would just like to narrow it to the smaller insurers. There has been a lot of concern expressed over the years that if we repeal or modify McCarran-Ferguson, it is going to hurt the small insurers. And I wanted to just ask you about your view, the concern about the impact of H.R. 9 upon these smaller insurers, because certainly they won't have access to the same actuarial data they now have.

Is that a fact we should consider in the drafting of this legislation?

Ms. BINGAMAN. It absolutely is a fact that is appropriate to consider. Without any question I think this committee needs to consider it, that we do, and that the Congress does. It is a central issue here. And I think what the committee needs to address is precisely what would be available to small businesses and how they could fill in the gaps. I think the committee needs to do that in as much detail as possible, and we do, too, in our analysis.

As I understand it, just a quick overview, the historical loss data which is collected, the first element of the four elements on which loss costs are currently computed, would remain available. As I understand it, loss development costs would also remain available.

So what would not stay in possibly, but depending on the safe harbors that the committee ultimately adopts as to which we are not addressing today, we aren't addressing H.R. 9 as such, we are addressing the need for reform.

But assuming that trending, for instance, would not allow the adjustment expense, I don't know what the committee does with that. I can't predict that. Trending is a major issue, of course—and we have concerns about trending, because it creates the basis, a major element of the cost basis from which price can then be computed, and that is our anticompetitive gut issue, and our view is that trending needs to be looked at very, very hard.

But the question for small businesses is, is there a way that they can economically and reasonably be expected to replace the trending that is currently done by the service bureaus themselves? And as we understand it, it is not complicated. It is actuarially a reasonably simple exercise, and it can be replaced. And I think the 2- to 4-year transition period that is in the bill seems like a helpful thing.

But absolutely, the impact of this on small businesses, what they would do and how they could get up to speed and operate in a different environment, is of bedrock importance.

Mr. FISH. I am glad to hear that. Thank you very much.

Mr. BROOKS. Mr. Berman. The gentleman from California is recognized out of order because of the special contribution he can make to this hearing and in recognition of the tremendous responsibilities he has on several committees and areas.

Mr. BERMAN. Well, I thank the chairman. My apologies to all my colleagues whom I am jumping ahead of in this process. I just wanted permission to have my opening statement included in the record, and perhaps somewhat whimsically to make a point about the opposition to this bill coming from the insurance industry.

Several years ago in what I thought was a tortuous interpretation of the ERISA preemption clause, the Supreme Court made a decision that knocked down every State common law and statutory remedy for bad-faith insurance practices, leaving victims without any effective remedy. This is in the area of employer-sponsored benefits and health insurance. In a way, as Mr. Fish pointed out, this does get into the health insurance debate as well. So we put a bill in to correct what we felt was a misreading of this preemption clause.

When Congress passed ERISA, no one ever contemplated, no one ever stated that all those 50 State laws on bad-faith insurance

practices in employer-sponsored health benefits would be eliminated.

And, of course, the health insurance industry came out of the woodwork screaming and yelling about our bill to restore State remedies. "We can't restore 50 different regulatory schemes on bad-faith insurance practices. Do you know how confusing it is, do you know how unfair that is, do you know how difficult that is to deal with?" Yet this was a situation in which there was no remedy against those kinds of practices, and therefore very little disincentive to make payments quickly, not to cancel policies arbitrarily in health insurance areas, and all these kinds of things.

So when I hear them coming in on this legislation as they have for a number of years, sanctifying the notion of State regulation and the antitrust exemption, they sound sometimes as contradictory and inconsistent as Members of Congress.

I am in strong support of your bill, Mr. Chairman. Thank you.

Mr. BROOKS. Thank you very much.

Mr. BERMAN. And I welcome our new Assistant Attorney General. I appreciate the testimony of the witnesses.

Mr. BROOKS. Mr. Canady, the gentleman from Florida.

Mr. CANADY. Thank you, Mr. Chairman.

We appreciate your being here today. The first question I have is for Ms. Bingaman. Ms. Bingaman, can you tell us when you anticipate that the Department will have a position on the specific provisions of the bill that the committee is considering?

Ms. BINGAMAN. I don't have a date in mind. Having been in office a short time, we have not gone through every sentence and every word. But we hope——

Mr. CANADY. I understand that from what you said already. I am just wondering, do you have a plan for getting to a point where you can give us specific——

Ms. BINGAMAN. We plan to work closely with industry groups and the committee. I have been approached by two or three different groups here who have said, we would like to come in, and I have said, call up and we will see in the next 2 weeks or 3 weeks.

We are not dragging our feet on this. If that is the question, will we do this expeditiously, you bet. We will do everything we can to make this a priority. I don't have a deadline as such, but this is a matter that needs to be worked through with the industry.

This whole safe harbor issue and the proper drafting of it, simple repeal would be easy, just as the chairman said, draw the lines and fight it out, see who is left standing at the end.

But that isn't what we are talking about. We are talking about very carefully considered, really serious drafting here. And that takes work. And I am sure you recognize it better than I do.

But in any event, we stand ready to work immediately, closely, continuously, and do everything we can to do our part of this to the extent our views are desired and important. We are ready to do that.

Mr. CANADY. Thank you.

Let me ask you about one specific practice in the industry, and that is the use of uniform forms and manuals by companies. Do you believe that is a practice that has any benefits for consumers?

Ms. BINGAMAN. I don't have any question that it is a practice that has benefits for consumers, in a couple of ways. It has benefits for the companies, too. I think this is a complicated issue, frankly, a complicated policy judgment, this use of standard forms.

For consumers, obviously, it allows them to look at what otherwise could be complex and almost incomprehensible, potentially, and say, this is apples, this is oranges, this is bananas; now, whose apples, oranges, and bananas do I want to buy?

So it simplifies it for consumers, and that is unquestionably a procompetitive aspect of this that is a benefit. It simplifies the reporting of historical data for the companies, because it allows this historical loss data, which is unquestionably available under standard antitrust analyses in any industry, and certainly this one also, to be made on, again, an apples and apples basis so the data are meaningful.

On the other hand, there is another side to it, of course, which is, it stifles innovation and it stifles competition in the products which are being offered. In the same way that it standardizes it, makes it apples and apples, it does keep you from offering grapes, and somebody might want grapes.

So in most industries, certainly the banking industry, for instance, or the credit card industry, there is no product standardization. There are all sorts of different ways people can do home loans and mortgages and refinance and all kinds of things. The standardization imposes a real cost, because there is not innovation, there is not a range of products. Company X isn't free to say, hey, I have a better mousetrap, let's try this. And that is a problem, because our whole economy is based on that.

So I don't sit here and tell you there is a knee-jerk answer to it, because truthfully I don't have one. But it is a critically important question, and I think there are pros and cons to it. That is my honest assessment.

Mr. CANADY. Do you have a view on how the bill would impact on that practice?

Ms. BINGAMAN. Impact what?

Mr. CANADY. On the practice of using uniform forms and manuals.

Ms. BINGAMAN. I am not closely familiar with H.R. 9, because we didn't come here to testify on H.R. 9 specifically. I think the standard form issue is a major issue on which the committee needs to decide whether a safe harbor is justified or not, turning on policy questions like the ones we have talked about.

Mr. CANADY. Thank you.

Mr. Price, could you comment on that same issue?

Mr. PRICE. Basically I think H.R. 9, at least as I understand it, would protect, if you will, the use of standard forms. Manuals may be something a little different, depending on what level of detail you put into it. But the standardized form in the insurance industry is no different than any other product standardization that exists in any other industry.

The first level of protection lies in the fact that the antitrust laws generally take a very flexible approach to standardization, as long as the matter has a procompetitive benefit which isn't outweighed by the anticompetitive effects which Ms. Bingaman re-

ferred to. Clearly the law is not going to interfere with legitimate product standardization activities.

The second part is that many of the standardized forms that exist within the industry are subject to detailed State regulation, and indeed in many States are subject to prior approval or some other form of review and approval, which would qualify it for the State action defense.

So that on either of those levels, to the extent that there is commercial necessity for standardized forms, the antitrust laws are, one, sufficiently flexible to accommodate them, and two, the State regulatory environment will protect them where it is necessary to the proper functioning of the industry.

So I don't think there is a problem under H.R. 9 as it is written with respect to the existence and use of standardized forms.

Mr. CANADY. In your view, in striking the balance between the procompetitive effects and the negative impact of the use of standardized forms, where does that balance in your mind? Is that, on balance, beneficial to consumers or not?

Mr. PRICE. It depends upon which segment of consumers you are talking about. If you are talking about a consumer buying a personal umbrella policy, a car policy, or indeed even the small business entity that is buying a standard business policy, in those instances they lack the adequate sophistication to meaningfully assess the differences in the multitude of forms, unless—and there is a significant "unless"—unless the insurance brokers and agents who sell them the forms are willing to step up and accept the additional liability exposure that would be imposed on them to exercise their professional judgment in a manner that best serves the interests of their clients.

So one of the things that standardized forms do is provide a happier environment for errors and omissions coverage for insurance agents. And the other segment of the insurance consuming public where you are dealing with a sophisticated purchaser who buys his policy through the services either of an in-house risk manager or consulting risk manager, standardized forms probably on balance don't benefit them, because it minimizes the range of options that they can structure to cover the specific risks represented by their company, which might be materially different than the structure of risks anticipated within a standardized form.

So on balance, it depends on what segment of the economy or the purchasing economy you are looking at. But specifically, with respect to the largest number of purchasers, individuals, on balance, it is probably both good and necessary.

Mr. CANADY. Thank you.

Mr. Price, I have an additional question for you. In your testimony you mention that modern technology creates a different situation than existed in the era of the McCarran Act, when it was first adopted.

What I would like to ask you, though, particularly with respect to small and regional companies, isn't the situation here really not one that is affected by exchanges in technology, but one that is, most importantly, affected by access to a broad range of actuarial data or the lack of access to such a broad range of data? And isn't

such a lack of access to the small and regional companies a problem that we have to take into account as we consider these issues?

Mr. PRICE. Actually, I would like to respond to that on three different levels. The first and somewhat superficial level is that in 20-odd years of being an antitrust prosecutor, any time an issue of regulatory reform has come up, the first person handed up to the table is the small businessman who will, it is claimed, inevitably fail when the protections of the regulatory environment disappear. Typically, in my experience, small businesses have thrived much more so than the bigger entities. Frequently, it isn't even the small businessmen who are putting forward their own protection.

The second part of the response is that many of the so-called small insurance companies, which by any individual's assessment are reasonably large companies to begin with, are specialty niche players in the market that sell to more homogenous risks than the broader range of the P&C company who attempts to serve the entire range of the liability customers.

Within those specialized niches which they frequently tend to write, they require less access to the broader range of data represented by the entirety of the market. They understand their particular niche to a greater extent than any of the people, including ISO, who are preparing the kind of statistical reports that are available and frequently relied on by others.

So I would say that a significant segment of the "mom and pop" market has less need for access to data than do larger companies selling a more diverse book of business.

The third response is that given the advent of the phenomenal computing power available even in desk top environments, much of the data necessary to do the proper analysis of a risk can be downloaded from the service bureau's computer to the using company's own computing environment, with the proper software to allow them to do some extremely sophisticated actuarial operations at reasonably cost-effective rates.

So I think that the advent of technology to the extent they need access, the access is available through the existing service bureau, and the technology with which to utilize that data exists to allow them to do it in a cost-effective manner.

Mr. CANADY. But the question is, having the data to begin with, as I understand it, I mean, you can have all the software in the world but you have to have the data. The question is, how will the policy decisions we make here interfere with their access to that data?

Mr. PRICE. There is nothing that I see in this legislation that in any way impedes the existence and distribution of that data. I mean, ISO exists, it is out there, it is in business to collect and sell data. As far as I know, the bulk of these "mom and pop" companies are members in good standing in ISO. I have no reason to believe that ISO, out of some notion of increased antitrust exposure, is going to somehow discriminatorily cut off access to that data by mom and pop companies.

Mr. CANADY. With respect to the trending data, under the provisions of the bill, that would be phased out after 4 years?

Mr. PRICE. Correct.

Mr. CANADY. So how is that going to affect these small companies?

Mr. PRICE. Trending is an actuarial operation they can either provide for themselves through inside employees or outside consultants. A number of people do it. In fact, when the municipal segment of the P&C market was effectively cut off from access to liability coverage in the mid–1980's, one of the reactions of municipalities was to form insurance or risk retention pools and to effectively become joint self-insurers. Now, in order to determine how to assess the costs of the retainage for the operation of those pools, they had to go out and hire actuarial consultants to provide those services.

No municipality's cost of insurance went up outrageously simply by reason of having to go hire an actuary or having to do the analysis necessary to price the product they were distributing. Indeed, if municipalities on a collective basis can go out and do that, I have seen no reason why any mom and pop company, many of which have $20 to $40 million or more in paid-up surplus, would lack the wherewithal to make the modest additional investment necessary to obtain actuarial services. I just don't see that as a realistic limitation on their ability to continue to function.

Mr. CANADY. Thank you.

Mr. BROOKS. Mr. Mann.

Mr. MANN. Thank you, Mr. Chairman.

I want to thank both of you for being here this morning.

Ms. Bingaman, I don't really have a question except to say that I look forward to your analysis and critique of the specific provisions of H.R. 9, and any suggestions you have for additional provisions or additional details we ought to take that into account before we move forward.

Mr. Price, H.R. 9, as you know, would eliminate the exemption to the extent that insurance business is not regulated by the States. And I was curious to know whether you or your organization has attempted to undertake any analysis of what that really means, what is no longer subject to the exemption in a particular State.

Do you have any analysis or information on what this will mean State by State or what it will mean as to those States that regulated intensively as compared to those States that do not?

Mr. PRICE. I don't have detailed data to give you on a State-by–State basis, but I think you have effectively already taken care of the problem perhaps in a way that may or may not have been anticipated as the primary focus of the provision, by providing for a 2- and 4-year phase-in. That transition period also operates for the benefit of the State regulators who must adjust their activities to a new legal environment.

One of the things that I know from my own experience in the aftermath of the State of New Jersey's adoption of the Fair Automobile Insurance Reform Act was the fact that two things in that act caused concern on the part of the industry. One, we repealed their State antitrust immunity for the auto insurance segment of the industry, and two, adopted a provision prohibiting collective action for ratemaking purposes other than the distribution of historical data.

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Now, by repealing the State act—not the State action but the State antitrust immunity—there is a catchall immunity provision in the State act that is in some respects analogous to the State action doctrine for where it is otherwise permitted by law.

One of the first things that happened, when the industry realized there was a new liability exposure out there, is they beat a path to the regulator's door, saying, Mr. Regulator, we are now exposed to liability for a variety of things that we previously did under your regulatory umbrella which may now be exposed to liability unless you make adjustments in the regulations to more precisely define what our obligations as regulated parties are.

So I think that one of the important things to look to is that there is an important transition period during which the industry and the regulators will intensively review the details of each State's regulatory system and decisions will be made by the industry, by the regulators, and by the State legislatures as to what level of protection is required in the regulatory environment of each State.

So simply looking out at the environment as it currently exists, which arose under the benign neglect of McCarran, won't answer the question, because you are in effect asking the same question that insurance companies are being asked, and that is to predict a future event.

Mr. MANN. So we would expect in many States then that the regulation would become more intensive at the request, perhaps, of the industry?

Mr. PRICE. That would not surprise me at all.

Mr. MANN. Thank you, Mr. Chairman.

Mr. BROOKS. Mr. Goodlatte, are you ready?

The gentleman from Virginia is recognized.

Mr. GOODLATTE. Thank you, Mr. Chairman.

Ms. Bingaman, I was interested to hear you say the survival of small business is a critical issue. Do you have any economic analysis that has been conducted that would confirm your suspicion that small insurance companies would not be adversely impacted by the change that is being proposed here?

Ms. BINGAMAN. I don't know. I am not aware of studies as such conducted solely focused on small business. The issue I am aware of is this question. The main issue I am aware of is whether they can conduct trending on their own through actuaries that they hire, in-house people, whether that was possible if trending were not allowed under some McCarran reform.

The information I have is consistent with Mr. Price's testimony a few minutes ago that that was not a major problem. It wasn't a major cost issue. And that it was feasible, and that this transition period of 4 years for small business would give them ample time to gain their own experience side by side with the trending which would be provided for that 4-year period by the service bureau.

So that is the analysis that I am aware of.

Mr. GOODLATTE. One of the things that concerns me is that every time we regulate in the Congress—and let's make no mistake about it, we are not simply talking about changing the antitrust exemptions here. We are opening up the door to the Federal Trade Commission—the door that leads to substantial regulation of the insur-

ance industry by the Federal Government. Every time we do that, oftentimes it has severe unintended consequences by not conducting economic impact studies, by not having some idea in advance of the consequences of the actions that we take.

I am concerned that the insurance industry is very different from a lot of the other industries. It is not like selling soap or hamburgers or automobiles, because every single insurance policy is different from every other insurance policy, because of the risk factor involved.

Do you have any comments on that?

Ms. BINGAMAN. I agree with you, it is different from a lot of businesses, but it is similar to some businesses, too. It is similar it seems to me in some ways to banking, in which small banks take on credit risks one at a time, and they have to individually size up the likelihood of that particular borrower defaulting and assess a multitude of factors and weigh it. It is very much a judgmental thing, and if they are wrong they may be wrong for a lot of money.

So there are other small businesses who deal with assessing risk on a future basis, who don't have broad antitrust exemption and who in fact function on a stand-alone basis and stay in business. So that suggests to me it is not quite as unique as it might sound.

Mr. GOODLATTE. I can certainly see a similarity to the banking industry, but I cannot see that regulation of the banking industry has been a resounding success.

Ms. BINGAMAN. But on the competition front, we are talking about antitrust exemptions. The banking industry issues you are talking about are totally different from antitrust. On the antitrust front, I would think there has been success, honestly. I'm not aware of any real failures in that regard. I think it has been a pretty impressive record of success.

Mr. GOODLATTE. I am concerned about opening Pandora's box, though, getting into this area.

Mr. Price, why is it that the States with the greatest degree of regulation of the insurance industry are the States that have the highest insurance cost to consumers?

Mr. PRICE. I am not sure if there is a corollary there or not and I have not made a study of it to know. Coming from one of those States that has high costs and lots of regulation, if somebody finds an answer, I would sure like to know it.

Mr. GOODLATTE. I would, too, before we vote on a bill that effectively encourages greater regulation and opens the door for Federal regulation in the case of those States who have, in the wisdom of their legislatures, not seen the need to regulate the insurance industry as much as some other States. Heavy regulation has driven a lot of insurers out of those markets.

I would hope that as you continue your tour of the insurance capitals, you would come down to my neck of the woods, where I would like it take you to Stanton and Harrisonburg and Roanoke and Lynchburg where we have some very small insurance companies in some very small buildings.

Mr. PRICE. Actually I have been in all those places but not for the purpose of visiting insurance companies.

Mr. GOODLATTE. Well, they are there, and they employ hundreds, if not thousands of people in my district, and I am concerned about them.

Thank you.

Mr. SCOTT [presiding]. Thank you.

I just had a couple of comments to make before I ask a question or two. I wanted to introduce a letter from the attorney general of the Commonwealth of Virginia into the record. I will just read parts of it.

He is recommending—he says, "Former Attorney General Mary Sue Terry and I have followed this bill with the greatest of interest, and I am pleased to recommend your support for this measure. You will recall Attorney General Terry placed a high priority on protecting the citizens of Virginia and the economy of the Commonwealth from unfair and anticompetitive business practices both through enforcement of the antitrust laws and the development of public policy initiatives. Consistent with that interest, she recommended in the 1987 Session of the Virginia General Assembly House Joint Resolution 330 . . . memorializing Congress to repeal the insurance industry's exemption from federal antitrust laws. The General Assembly enthusiastically supported that resolution, joining a diverse group of public officials, business leaders, and citizen advocates who urged Congress at that time to adopt repeal legislation."

And without objection, I would like this letter and the accompanying resolution to be entered into the record.

[The information follows:]

COMMONWEALTH of VIRGINIA

Stephen D. Rosenthal
Attorney General

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Supreme Court Building
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July 28, 1993

The Honorable Robert C. Scott
United States House of Representatives
501 Cannon
House Office Building
Washington, D.C. 20515

Re: H.R. 9

Dear Congressman Scott:

I am writing in response to your request for a recommendation regarding H.R. 9, legislation pending before Congress to modify the insurance industry's antitrust exemption under the McCarran-Ferguson Act of 1945. Former Attorney General Mary Sue Terry and I have followed this bill with interest, and I am pleased to have an opportunity to recommend your support for this measure.

You will recall that Attorney General Terry placed a high priority on protecting the citizens of Virginia and the economy of the Commonwealth from unfair and anticompetitive business practices both through enforcement of the antitrust laws and the development and promotion of public policy initiatives. Consistent with that interest, she recommended to the 1987 Session of the Virginia General Assembly House Joint Resolution No. 330 (*enclosed*) memorializing Congress to repeal the insurance industry's exemption from the federal antitrust laws. The General Assembly enthusiastically supported that resolution, joining a diverse group of public officials, business leaders, and citizen advocates who urged Congress at that time to adopt repeal legislation.

Although H.R. 9 now represents an effort to modify in certain respects, rather than completely repeal, the broad immunity from the antitrust laws granted to insurers, it is a meaningful step in the right direction. Therefore, consistent with the positions of both my predecessor and the National Association of Attorneys General, I recommend that you support passage of H.R. 9.

Please do not hesitate to contact me if my Office can provide you any additional information regarding this recommendation.

Very truly yours,

Stephen D. Rosenthal

Stephen D. Rosenthal
Attorney General

GENERAL ASSEMBLY OF VIRGINIA – 1987 SESSION

HOUSE JOINT RESOLUTION NO. 330

Memorializing Congress to repeal the insurance industry's exemption from federal antitrust laws.

Agreed to by the House of Delegates, February 4, 1987
Agreed to by the Senate, February 24, 1987

WHEREAS, the Sherman Act, the Clayton Act, and decisional law prescribe the appropriate standards of conduct for competing businesses and for individual firms acquiring and exercising market power in the United States; and

WHEREAS, those laws prohibit activities in restraint of trade that have repeatedly been shown to be harmful to the economy and injurious to consumers; and

WHEREAS, in 1944 the Supreme Court determined, in *United States v. South-Eastern Underwriters*, 322 U.S. 533, that the business of insurance constitutes commerce within the scope of the antitrust laws; and

WHEREAS, in 1945, Congress, apprehensive about the effect of *South-Eastern Underwriters* on the powers of state to tax and regulate insurance, adopted the McCarran-Ferguson Act (15 U.S.C. §§ 1011-1015), granting the insurance industry broad exemptions from most provisions of the Sherman and Clayton Acts, including the proscriptions against such anticompetitive practices as price-fixing, agreements not to compete, monopolization, tying agreements, and a wide range of other conduct that is unlawful for nearly every firm outside the insurance industry; and

WHEREAS, subsequent developments in antitrust law have made it clear that nothing in the Sherman and Clayton Acts would hinder the exercise of traditional state powers of taxation and regulation, including price regulation, making the McCarran-Ferguson Act unnecessary for the purposes that originally motivated Congress to enact it; and

WHEREAS, it is also clear that nothing in the antitrust laws prohibits insurers from sharing information on losses in order to price their product, or from engaging in reinsurance and other risk-sharing arrangements common to the industry, making the McCarran-Ferguson Act unnecessary to the legitimate needs of the insurance industry; and

WHEREAS, the insurance industry is critical to the national economy, with Americans paying over $140 billion per year in premiums on property and casualty insurance alone, and with insurance being a necessity for many enterprises; and

WHEREAS, serious questions have been raised about the current crisis in liability insurance and whether the unavailability of insurance to many governments and businesses is the product of the industry's antitrust exemption; now, therefore, be it

RESOLVED, by the House of Delegates, the Senate concurring, That the General Assembly of the Commonwealth of Virginia does hereby memorialize the Congress of the United States to repeal the immunity from the antitrust laws granted to the insurance industry and to subject insurance companies to the rules of the competitive marketplace applicable to other firms, recognizing the historic right of the states to regulate and tax the business of insurance; and, be it

RESOLVED FURTHER, That the Clerk of the House of Delegates transmit copies of this resolution to the Speaker of the United States House of Representatives, the President of the United States Senate, and the members of the Virginia delegation to the Congress in order that they may be apprised of the sense of the General Assembly.

Mr. SCOTT. To both of the panelists, I assume, if there is ample competition, the free marketplace will take care of any problems in pricing and making insurance available. Is that an accurate statement?

Ms. BINGAMAN. That is a core belief of the American economy, and I believe it, yes.

Mr. SCOTT. What happens in those lines of insurance where there is not adequate competition? There are a number of lines of insurance where you may only have one or sometimes two carriers that are not competing vigorously, and the businesses that need the insurance are somewhat stuck with whatever the price is.

How do you deal with a situation if you are relying on competition if there is in fact no competition in those lines?

Ms. BINGAMAN. How do you inject more competition into the marketplace?

Mr. SCOTT. How do you regulate the industry to make sure it is available at a fair price, and that the insurance companies aren't gouging?

Ms. BINGAMAN. We rely on competition in this country to be sure that people aren't price gouging. The basic methodology we have believed in, as we have said here a couple of times, for a hundred years is to be able to go to Joe Blow down the street, if you don't like the price of Sam, walk on down the street, keep walking until you find a better price.

The problem is, if the costs, the overwhelming majority of the cost of the product being priced is known to all the competitors so that they all know the price, and they all can infer the price, I should say, quite simply, which is the argument used about the problem for trending, then it deflates and depresses the competition necessary to get goods at a low price. That is just about all there is to it. It tends to stabilize prices, because you have very fundamental cost factors which are shared in common and known to each other.

So as I understand it, Congressman, a major purpose of reform of McCarran-Ferguson is to inject elements of competition into this very crucial industry for all consumers in this country, business, individuals alike.

Mr. SCOTT. Mr. Price.

Mr. PRICE. The first level of answer is, if in reality you have a very limited number of sellers, one or two or maybe even one, for a particular class of insurance, and if in fact they are charging a price that is excessive in relationship to the risk exposure, the insurance industry generally doesn't have any substantial barriers to entry. Once you are in the industry writing a significant book of business with respect to one line, the incremental cost of moving into another line probably wouldn't prohibit you from simply saying that if it is in fact excessive, that that would simply attract entry, and that the entry would discipline the excessive prices.

If there is some reason peculiar to the risk or the market that would not allow or permit this additional entry, then it becomes a question probably for State public regulation to focus on whether the monopolist, if you will, both enjoys a position of substantial market power and is exercising that power in a way that is harmful to the public, and take appropriate action within that context.

Mr. SCOTT. Thank you.

Mr. Inglis.

Mr. INGLIS. Thank you, Mr. Chairman.

One of the things that I am becoming very aware of is that specific legislation is, of course, borne out of broad philosophical points of view. And the question I would like to ask both of the witnesses is, given the general reputation of this committee as somewhat maybe even significantly to the left of the political center, and the fact that the Clinton administration notwithstanding comments prior to November 3, 1992, has proven to be significantly to the left of the political center, can you assure me that what we are not talking about here is really two things: one, an opportunity to grow the Government, the Federal Government, and to build some more buildings. I must say about those buildings in Omaha, Jacksonville, and Hartford, probably none are as expensively constructed as the one in which we reside now, and none have rooms more expensively appointed than the one we are in now.

But based on that, those observations about the philosophical view here, can you assure me that this isn't an opportunity to grow a role for the Federal Government to supplant State regulation? As the chairman indicated, he has very little regard for the State regulators.

And second, isn't this really an important program for the Trial Lawyers Association. Isn't that really——

Ms. BINGAMAN. Let me dispute every single point you started with. I don't buy any single one of your premises.

Number one, I have no knowledge about this committee. I can't speak to that. But your characterization of it as significantly left of center of the American people, I don't think I buy it.

I do have knowledge about the President, and I absolutely do not remotely buy your characterization of him as, quote, left of center. I think that is fundamentally wrong. The President is doing the absolute middle-of-the-road thing the people want, which is getting the deficit cut. So that is number two.

Number three, this is not an opportunity to grow the Federal Government. This is about competition between businesses. The Federal Government was set up—the Antitrust Division of the Federal Government is set up to ensure that competition works. We are here to see that competition works without intervention of government.

The fundamental idea of the Sherman Act is that we don't have government regulation except to be sure that competition is working.

So the fundamental premise of this bill is about private competition. And I could not disagree more with just about everything you said.

Mr. INGLIS. Do you not agree it would require more Federal regulators in order to implement what you are talking about?

Ms. BINGAMAN. I dispute that 1,000 percent. I disagree totally with that.

Mr. INGLIS. So in other words we would not be supplanting any State regulations, so that we would not be creating any new Federal regulations?

Ms. BINGAMAN. No. Not one dime or dollar to the Federal budget is needed because of this bill, that I have ever heard of or been aware of, and I dispute any notion of that.

Mr. INGLIS. That just doesn't stand to reason. If we are expanding the scope of a Federal law——

Ms. BINGAMAN. We are not expanding the scope of the Federal law. We are narrowing the scope of an exemption.

Mr. INGLIS. The effect is the same, I would submit.

Ms. BINGAMAN. No, it is not. We are not adding regulation. We are saying competition—let me tell you what the fundamental premise of the Sherman Act is. It is that private businesses out there in the economy compete with each other and you don't need regulation. The Communists went the other way. They said, we are going to tell everybody what to do with massive regulation. We are totally and completely and fundamentally opposite from that as a country. And we as an Antitrust Division are totally opposite from that.

We are only 300 lawyers for the whole U.S. economy. If that strikes you as massive regulation for a six trillion dollar economy, I don't think it is.

Mr. INGLIS. For those 300, then, after the exemption is repealed and the State regulators are put out of their oversight responsibilities that the chairman said he doesn't believe they are exercising, do you not think there will be a few more regulators needed at the Federal level to do what the State regulators used to be doing?

Ms. BINGAMAN. Congressman, you have said the only time I have heard it said today and the only time I have ever heard it said that State regulators are going to be put out of business. I don't think that has ever been said. I don't think that is true.

State regulators stay in business with this bill. State action law remains the same. Insurance companies can go to them for regulation. I mean, nothing changes about State regulation. They are not being obliterated. Nothing is being added to the Federal Government. We are simply saying, compete more in whatever areas are not safe harbored.

To imply that this bill means massive regulation by the Federal Government is simply, flatly, totally wrong. It really is.

Mr. INGLIS. I can't imagine that you wouldn't concede, though, that if you repeal an exemption, it thereby becomes a larger role for the Federal Government, that doesn't necessitate——

Ms. BINGAMAN. There becomes a role for competition. Businesses compete with each other. The Federal Government doesn't regulate every corner grocery store because the Sherman Act applies to it. Those grocery stores conduct their own businesses as they see fit. They sell green beans for 19 cents, this guy sells them for 2 cents. You call that regulation by the Federal Government? Not at all. That is competition. That is what this is about.

And what we are saying is, we think insurance companies should have to compete the same way the corner grocery store does, by figuring their own costs, figuring their own prices, and offering products in competition. That is not regulation. That is competition.

Mr. INGLIS. I just think it would be interesting—over time, if this bill is passed, it would be interesting to chart the growth of any Federal Government bureaucracies that may accrue as a result of

this, and it will be very interesting to see—I cannot imagine that they would not grow. It just——

Ms. BINGAMAN. I cannot imagine that they will. So you and I are fundamentally at odds, is all I can say.

Mr. INGLIS. Let me ask you something. The bill specifically says that the FTC would regulate the trade practices of the insurance industry. Do you not assume they will hire a few more people at the FTC to do that?

Ms. BINGAMAN. No.

Mr. INGLIS. So everybody at the FTC is not at maximum utilization, then? In other words, if we are going to add regulation at the FTC level, do you not admit that there would be additional people employed and there will be an additional role for the Federal Government?

Ms. BINGAMAN. I don't admit that at all. I will tell you in my tenure—well, you manage a business by managing it by priorities. Managing a government division is no different than managing a business.

Mr. INGLIS. I would submit there is a difference. Business has a bottom line. Government, there is no such thing as a bottom line. That is the essential problem.

Ms. BINGAMAN. You and I disagree on that also. The bottom line is accountability to the public, your effectiveness as an agency and what product you deliver, and you are judged by that every day, as you absolutely should be.

Mr. SCOTT. The gentleman's time has just about expired.

Mr. INGLIS. I yield back the balance.

Mr. SCOTT. Thank you. Thank you very much.

We will go on to the second panel. We appreciate your testimony.

The next panel consists of Robert Vagley and Eric Gustafson.

Mr. BROOKS [presiding]. The first witness on this panel will be Robert Vagley, president of the American Insurance Association, who has been making a commendable effort in the cause of reasonable McCarran reform.

We will next hear from Mr. Eric Gustafson, a weight lifter who will testify on behalf of the Independent Insurance Agents of America, of which he is president. While others in the industry may assert that they represent the small business, Mr. Gustafson has lived the life of a small businessman. He knows the small niche players and the potential they have to help the American consumer.

Gentlemen, we thank you for being with us. I hope you will limit your comments to 5 minutes. We will accept all of your statements for the record.

Mr. Vagley.

STATEMENT OF ROBERT E. VAGLEY, PRESIDENT, AMERICAN INSURANCE ASSOCIATION

Mr. VAGLEY. Thank you very much, Mr. Chairman, members of the subcommittee. Ladies and gentlemen, good morning. My name is Robert Vagley. I am president of the American Insurance Association. I am also very pleased to be here this morning to discuss with you our mutual interest in solving the longstanding debate over the scope of the McCarran-Ferguson Act.

Although the McCarran debate has at times been characterized by intense acrimony, I would like to take this opportunity to thank you, Chairman Brooks, for your willingness to work to develop a constructive approach to dealing with this important public policy issue.

As members of this subcommittee are well aware, McCarran-Ferguson is the law enacted in 1945 which entrusts the regulation of insurance to the States. Most of the recent public policy debate, however, has centered around the act's antitrust provisions, which provide an exclusion from the Federal antitrust laws for the business of insurance to the extent it is regulated by State law. No exclusion exists for acts of boycott, coercion, or intimidation.

AIA firmly believes that the protections afforded by the McCarran-Ferguson Act have helped shape the insurance industry into a highly competitive, innovative provider of essential consumer services. However, we also understand that the act has allowed questions to be raised about industry behavior, both by this body and by the public at large.

I believe it is possible to amend McCarran-Ferguson in a manner that resolves those questions without destroying the ability of the industry to engage in critical collective activities that enhance competition. And I believe that the chairman shares these goals as well.

In previous testimony before the subcommittee, AIA has repeatedly expressed its views about the major problems presented by H.R. 9. But my purpose today is not to focus on these problems. They have been well discussed. Rather, I wanted to express to you again, Mr. Chairman, our desire to work with the subcommittee to develop consensus legislation for amending the McCarran-Ferguson Act, to achieve as you earlier described, balanced reform, what Ms. Bingaman described as thoughtful, careful reform, and in all events to provide broader markets for the business of insurance.

In 1991 AIA developed a proactive policy for amending the McCarran-Ferguson Act. We support the establishment of safe harbors for certain essential business activities, areas that need to be addressed in order to reconcile the several and legitimate competing concerns.

Specifically, safe harbors would be provided for the collection and dissemination of data, including historical data, loss development and trending; form standardization; joint underwriting and pooling; and fire inspection and data development.

Activities within the safe harbors would be subject to current antitrust standards under McCarran-Ferguson. That is to say, they still would have to be undertaken pursuant to a State's insurance regulatory law, and would be subject to McCarran's current prohibition against boycotts, coercion, and intimidation.

For activities that fall outside the safe harbors, both the Sherman and Clayton Acts would apply as would all rules of general antitrust applicability.

However, the FTC Act would not be applicable to the business of insurance, as is the case under current law. A reasonable transition period would be provided in order to permit both large and small companies to conform their business practices to the new antitrust environment.

We believe that the AIA approach is a constructive means to address the legitimate concerns of the law's critics while safeguarding the industry's essential business practices.

I should emphasize that this proposal, our proposal, represents a significant departure from the status quo. It is not business as usual for insurers or agents, State regulators, or the insurance buying public. However, we also believe that, given a reasonable transition period, the industry can continue to provide the high-quality, cost-sensitive product that we have provided in the past.

After releasing our proposal more than 2 years ago, AIA began working with you, members of the subcommittee, and outside groups, including the consumer community, to develop consensus legislation. We were disappointed that a resolution could not be achieved.

However, in the past several months I have been personally engaged in additional discussions with your staff, Mr. Chairman, and I am increasingly optimistic about the possibility of satisfactorily resolving this issue in the near future.

Thank you very much for inviting us to testify. I would be pleased to answer any questions you might have.

[The prepared statement of Mr. Vagley follows:]

TESTIMONY OF
ROBERT E. VAGLEY
AMERICAN INSURANCE ASSOCIATION
ON MODIFICATION OF THE McCARRAN-FERGUSON ACT
H.R. 9
BEFORE THE SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW
UNITED STATES HOUSE OF REPRESENTATIVES
JULY 29, 1993

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, LADIES AND GENTLEMEN, GOOD MORNING. MY NAME IS ROBERT E. VAGLEY, AND I AM PRESIDENT OF THE AMERICAN INSURANCE ASSOCIATION ("AIA"). I AM PLEASED TO BE HERE THIS MORNING TO DISCUSS WITH YOU OUR MUTUAL INTEREST IN RESOLVING THE LONG-STANDING DEBATE OVER THE SCOPE OF THE McCARRAN-FERGUSON ACT. I ASK THAT REFERENCE BE MADE TO THE PREVIOUS AIA TESTIMONY ON THIS ISSUE.

ALTHOUGH THE McCARRAN-FERGUSON DEBATE HAS AT TIMES BEEN CHARACTERIZED BY INTENSE ACRIMONY, I WOULD LIKE TO TAKE THIS OPPORTUNITY TO THANK YOU, MR. CHAIRMAN, FOR YOUR WILLINGNESS TO WORK TO DEVELOP A CONSTRUCTIVE APPROACH TO DEALING WITH THIS IMPORTANT PUBLIC POLICY ISSUE. DURING THE LAST CONGRESS, AIA AND THE JUDICIARY COMMITTEE STAFF MADE EXTENSIVE EFFORTS TO RESOLVE OUR DIFFERENCES. WHILE OUR TALKS DID NOT REACH FRUITION, I BELIEVE THEY MADE REAL PROGRESS. FOR THE PAST SEVERAL MONTHS, I HAVE BEEN PERSONALLY ENGAGED IN ADDITIONAL DISCUSSIONS WITH YOUR STAFF, IN AN EFFORT TO SHAPE LEGISLATION WHICH WILL RESPOND TO THE LEGITIMATE PUBLIC CONCERNS ABOUT THE CURRENT SCOPE OF THE ACT--WHILE AT THE SAME TIME PROTECTING CRITICAL COLLECTIVE ACTIVITY ENGAGED IN BY INSURERS, PURSUANT TO STATE REGULATION. I

HOPE THAT THESE TALKS WILL LEAD TO A QUICK AND SATISFACTORY RESOLUTION OF THE ISSUE.

I. BACKGROUND

THE AMERICAN INSURANCE ASSOCIATION IS A TRADE ORGANIZATION COMPRISED OF APPROXIMATELY 250 PROPERTY/CASUALTY INSURANCE COMPANIES WITH ANNUAL PREMIUMS OF ABOUT $57 BILLION. OUR MEMBERSHIP CONSTITUTES A BROAD CROSS SECTION OF THE INDUSTRY, INCLUDING LARGER AND SMALLER COMPANIES WHICH WRITE BOTH PERSONAL AND COMMERCIAL LINES ON A NATIONAL AND REGIONAL BASIS. FOR THE PAST SEVERAL YEARS, VIRTUALLY ALL OF OUR COMPANIES HAVE BEEN ACTIVELY INVOLVED IN THE McCARRAN ISSUE THROUGH THEIR MOST SENIOR MANAGEMENT. OUR MEMBERSHIP HAS LONG BELIEVED THAT IT IS ESSENTIAL TO SATISFACTORILY ADDRESS THIS ISSUE, SO THAT CONGRESS CAN TURN ITS ATTENTION TO MORE CRITICAL ISSUES AFFECTING OUR INDUSTRY, SUCH AS SUPERFUND, INSURER SOLVENCY, CATASTROPHE PROTECTION, AND NATIONAL HEALTH CARE REFORM.

II. LEGISLATIVE OVERVIEW

AS MEMBERS OF THIS SUBCOMMITTEE ARE WELL AWARE, McCARRAN-FERGUSON IS THE LAW, ENACTED IN 1945, WHICH ENTRUSTS THE REGULATION OF INSURANCE TO THE STATES. MOST OF THE RECENT PUBLIC POLICY DEBATE, HOWEVER, HAS CENTERED AROUND THE ACT'S ANTITRUST PROVISIONS, WHICH PROVIDE AN EXCLUSION FROM THE FEDERAL ANTITRUST LAWS FOR "THE BUSINESS OF INSURANCE," TO THE EXTENT IT IS REGULATED BY STATE LAW. NO EXCLUSION EXISTS FOR ACTS OF BOYCOTT,

COERCION, OR INTIMIDATION.

OVER THE YEARS, THE SUPREME COURT, ON SEVERAL OCCASIONS, HAS INTERPRETED THE KEY TERMS OF THE STATUTE, MOST RECENTLY IN HARTFORD v. CALIFORNIA. WHILE THESE DECISIONS PROVIDE IMPORTANT LEGAL GUIDANCE FOR INSURERS AND REGULATORS, THEY CANNOT BE EXPECTED TO RESOLVE THE PUBLIC POLICY DEBATE. THAT REMAINS THE ROLE OF THE CONGRESS.

AIA FIRMLY BELIEVES THAT THE PROTECTIONS AFFORDED BY THE McCARRAN-FERGUSON ACT HAVE HELPED SHAPE THE INSURANCE INDUSTRY INTO A HIGHLY COMPETITIVE, INNOVATIVE PROVIDER OF ESSENTIAL CONSUMER SERVICES. HOWEVER, WE ALSO UNDERSTAND THAT THE ACT HAS ALLOWED QUESTIONS TO BE RAISED ABOUT INDUSTRY BEHAVIOR, BOTH BY THIS BODY AND THE PUBLIC AT LARGE. I BELIEVE IT IS POSSIBLE TO AMEND McCARRAN-FERGUSON IN A MANNER THAT RESOLVES THOSE QUESTIONS, WITHOUT DESTROYING THE ABILITY OF THE INDUSTRY TO ENGAGE IN CRITICAL COLLECTIVE ACTIVITIES THAT ENHANCE COMPETITION. I BELIEVE THAT THE CHAIRMAN SHARES THESE TWIN GOALS, AS WELL.

IN PREVIOUS TESTIMONY BEFORE THE SUBCOMMITTEE, AIA HAS REPEATEDLY EXPRESSED ITS VIEWS ABOUT THE MAJOR PROBLEMS PRESENTED BY H.R. 9. BUT MY PURPOSE TODAY IS NOT TO FOCUS ON THESE PROBLEMS; THEY ARE WELL KNOWN. RATHER, I WANT TO EXPRESS TO YOU AGAIN, MR. CHAIRMAN, MY DESIRE TO WORK WITH THE SUBCOMMITTEE TO

DEVELOP CONSENSUS LEGISLATION FOR AMENDING THE McCARRAN-FERGUSON ACT.

III. <u>A CONSTRUCTIVE ALTERNATIVE</u>

IN 1991, AIA, THROUGH A SPECIAL COMMITTEE OF OUR BOARD OF DIRECTORS, DEVELOPED A PROACTIVE POLICY FOR AMENDING THE McCARRAN-FERGUSON ACT. WE SUPPORT THE ESTABLISHMENT OF "SAFE HARBORS" FOR CERTAIN ESSENTIAL BUSINESS ACTIVITIES--AREAS THAT NEED TO BE ADDRESSED IN ORDER TO RECONCILE THE COMPETING CONCERNS. SPECIFICALLY, SAFE HARBORS WOULD BE PROVIDED FOR: (1) THE COLLECTION AND DISSEMINATION OF DATA, INCLUDING HISTORICAL DATA, LOSS DEVELOPMENT, AND TRENDING; (2) FORMS STANDARDIZATION; (3) JOINT UNDERWRITING AND POOLING; AND (4) FIRE INSPECTION AND DATA DEVELOPMENT.

FOR CONDUCT PERTAINING TO THE SAFE HARBORS, THE CURRENT ANTITRUST STANDARDS UNDER McCARRAN-FERGUSON WOULD APPLY--THAT IS TO SAY, THEY STILL WOULD HAVE TO BE UNDERTAKEN PURSUANT TO A STATE'S INSURANCE REGULATORY LAW AND WOULD BE SUBJECT TO McCARRAN'S CURRENT PROHIBITION ON BOYCOTTS, COERCION, AND INTIMIDATION. FOR ACTIVITIES THAT FALL OUTSIDE THE SAFE HARBORS, BOTH THE SHERMAN AND CLAYTON ACTS WOULD FULLY APPLY, AS WOULD ALL OTHER ANTITRUST RULES OF GENERAL APPLICABILITY, SUCH AS THE NOERR-PENNINGTON AND STATE ACTION DOCTRINES. HOWEVER, THE FTC ACT WOULD NOT BE APPLICABLE TO THE BUSINESS OF INSURANCE, AS UNDER CURRENT LAW. A REASONABLE TRANSITION PERIOD WOULD BE

PROVIDED IN ORDER TO PERMIT BOTH LARGE AND SMALL COMPANIES TO CONFORM THEIR BUSINESS PRACTICES TO THE NEW ANTITRUST ENVIRONMENT. A MORE COMPLETE DESCRIPTION OF THE PROPOSAL IS ATTACHED TO MY TESTIMONY.

WE BELIEVE THAT THE AIA APPROACH IS A CONSTRUCTIVE MEANS TO ADDRESS THE LEGITIMATE CONCERNS OF THE LAW'S CRITICS, WHILE SAFEGUARDING THE INDUSTRY'S ESSENTIAL BUSINESS PRACTICES. I SHOULD EMPHASIZE THAT THIS PROPOSAL REPRESENTS A SIGNIFICANT DEPARTURE FROM THE STATUS QUO--IT IS NOT "BUSINESS AS USUAL" FOR INSURERS, OUR AGENTS, STATE REGULATORS, OR THE INSURANCE-BUYING PUBLIC. HOWEVER, WE BELIEVE THAT, GIVEN A REASONABLE TRANSITION PERIOD, THE INDUSTRY CAN CONTINUE TO PROVIDE THE HIGH QUALITY, COST-SENSITIVE PRODUCT THAT WE HAVE PROVIDED IN THE PAST.

AFTER RELEASING OUR PROPOSAL MORE THAN TWO YEARS AGO, AIA BEGAN WORKING WITH YOU, MEMBERS OF THIS SUBCOMMITTEE, AND OUTSIDE GROUPS, INCLUDING THE CONSUMER COMMUNITY, TO DEVELOP CONSENSUS LEGISLATION. WE WERE DISAPPOINTED THAT A RESOLUTION COULD NOT BE ACHIEVED. HOWEVER, IN THE PAST SEVERAL MONTHS, WE HAVE RENEWED OUR EFFORTS. I AM OPTIMISTIC ABOUT THE POSSIBILITY OF RESOLVING THE ISSUE IN THE NEAR FUTURE.

THANK YOU AGAIN FOR INVITING ME TO TESTIFY THIS MORNING. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS YOU MIGHT HAVE.

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LAW DEPARTMENT

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AIA MCCARRAN-FERGUSON MODIFICATIONS
MAY 17, 1991

AIA is proposing modifications to the McCarran-Ferguson Act that establish safe harbors for certain essential business activities. For all other activities, all federal antitrust principles (except the Federal Trade Commission Act) fully apply. For conduct pertaining to the safe harbors, current McCarran-Ferguson standards are retained. Under the proposal, the modifications would become effective three years after enactment of legislation. The elements of the proposal are described below.

SAFE HARBORS

I Data Safe Harbor (historical data, loss development and trending)

(A) The data safe harbor includes a provision protecting collective activity by insurers and insurer organizations to collect, analyze, report and use historical data and information.

Under this provision, historical data and information means: (1) the collection, analysis, reporting and use of historical data and information, including, but not limited to, loss experience, exposures, reserves, allocated loss adjustment expenses and premiums; and (2) the development and use of procedures to collect, analyze and report historical data and information, including, but not limited to, statistical plans, for the collection of data and the classification of risks in conjunction with those plans.

(B) The data safe harbor includes a provision protecting collective activity by insurers and insurer organizations to develop, prepare and use "loss development."

Under this provision, the definition of "loss development" is the same definition used by the National Association of Insurance Commissioners (NAIC) in its model legislation, and reads as follows: "Developed losses mean losses (including loss adjustment expenses) adjusted, using standard actuarial techniques, to eliminate the effect of differences between current payment or reserve estimates and those needed to provide actual ultimate loss (including loss adjustment expense) payments."

(C) The data safe harbor includes a provision protecting collective activity by insurers and insurer organizations to develop, prepare and use "trend" factors. Under this provision, the definition of "trend" is the same definition used by the NAIC in its model legislation, and reads as follows: "The term loss trending means any procedure for projecting developed losses to the average date of loss for the period during which the policies are to be effective."

II Forms Standardization

The forms standardization safe harbor protects collective activity by insurers and insurer organizations in: (1) developing, preparing and using standardized insurance policy forms, bond forms, and endorsements; and (2) preparing and developing guidelines for their use.

III Joint Underwriting and Pooling

The joint underwriting and pooling safe harbor protects any risk sharing or risk spreading mechanism, including, but not limited to, any joint underwriting agreement, pool, faculty, treaty, contract, residual market mechanism, assigned risk plan, market assistance plan or similar arrangement whereby two or more insurers or reinsurers, jointly or severally, insure or reinsure one or more risks.

IV Fire Inspection and Data Development

The fire inspection and data development safe harbor

protects collective activity by insurers and insurer organizations in inspecting buildings with regard to fire hazards and determining the costs associated with the likelihood of loss due to fire; provided, however, that these inspections are undertaken pursuant to a program under state law authorizing schedules or procedures for determining, generally, the fire risks of buildings.

FTC JURISDICTION

Under the proposal, current law is retained with regard to the the Federal Trade Commission (FTC). Thus, the FTC would not obtain any additional jurisdiction over the business of insurance.

IMPLEMENTATION

I Effective Date

Under the proposal, the law would take effect three years from the date of enactment.

II Use of Exempt Conduct

Under the proposal, conduct that was proper under the McCarran-Ferguson Act prior to amendment could not be submitted into evidence in litigation under the new law. The same principle would apply to conduct within a safe harbor under the new law.

Mr. BROOKS. Mr. Gustafson.

STATEMENT OF ERIC G. GUSTAFSON, PRESIDENT, INDEPENDENT INSURANCE AGENTS OF AMERICA

Mr. GUSTAFSON. Thank you, Mr. Chairman and members of the committee. I appreciate the opportunity to be here today to discuss with you one of the most controversial issues facing the insurance industry.

My service as president of the Independent Insurance Agents of America is almost at an end and I will soon return to running my small business on a full-time basis. Incidentally, Mr. Chairman, you might like to know my business occupies 4,500 square feet in a very small building.

I do not approach this issue for theoretical or ideological reasons. My concerns are practical and rooted in the ability of independent agents and companies to serve the insurance buying public.

While my organization does not support H.R. 9 in its current form, I want to commend you, Mr. Chairman, for drafting a proposal that has engendered a discussion on the current state of the limited antitrust exemption conferred by the McCarran-Ferguson Act.

My association is not interested in protecting symbols. We are interested in improving insurance availability, maintaining and enhancing large and small company participation in insurance markets, and, most importantly, providing a product that the American people can afford.

You have heard in the past and you will hear again today that small companies need certain protections to enable them to compete fairly with large entities. I can tell you that the last 8 years have proven that many consumers and their agents have depended upon smaller companies to fill market voids caused by the withdrawal of some of the larger employers.

To what extent certain joint activities have enabled these smaller companies and insurers to remain competitive is a legitimate question and not a rhetorical smokescreen designed to thwart any change on these issues.

We have certain concerns, some of which you have addressed already, in the so-called safe harbors of H.R. 9. But there are other concerns you may want to address as well.

The most important issue for insurance consumers today is markets; that is, insurance companies that are willing and able to underwrite insurance. Due to natural disasters, the lack of affordable reinsurance, and other new risks, insurers are vacating many areas of the country, leaving agents to scramble for markets on behalf of their customers. That is why we believe that if McCarran is modified, it must not harm the competitive position of small or regional companies.

This goal requires the recognition of the importance of trending. Trending produces positive results for the consumer. Reliable trending helps reduce insurers' costs and the upward pressure on prices.

Accurate estimates of future payments gives insurers confidence as to the adequacy of their pricing decisions and reduces contingency factors and prices. It also helps insurers and regulators in-

sure company solvency by accurately accounting for future cost claims.

Even if small insurers could absorb trending cost, many companies simply have insufficient data to perform trending analysis. Insurers need a large data base of information about past losses in order to estimate future losses. A company trying to enter a new market will not have sufficient information to conduct trend analysis.

Second, no change should be made to McCarran that impedes the ability of agents to compare products of competing companies. Agents rely on the joint investment of uniform forms and manuals and other supplementary rating information. The ability of insurance companies to jointly develop comparable forms, policies, and other related information benefits independent insurance agents and consumers alike.

Any agent's ability to serve companies is dependent in large part on that agent's ability to compare different insurance products. Comparison would be difficult if not impossible if common forms could not be used or if companies could not standardize information that is used by agents to classify and rate a risk.

It is also important that any legislation protect voluntary and State-sponsored pooling arrangements that allow two or more insurers or reinsurers to provide coverage and incidental services.

We also believe the State action doctrine should not be diminished in any way. Without the State action doctrine, antirebating laws and similar laws regulating the relationship of insurers might be illegal, and any activity might come under the scrutiny of antitrust Federal prohibitions.

We believe that State regulation should prevail. You should know that this legislation may have the unintended effect of favoring direct sale of insurance over the use of independent agents by jeopardizing some activities that are unique to the independent agency system.

In particular, independent insurance agents are often involved in creating the individualized product that best suits the customer's wants and needs. An agent may, for example, simultaneously work with competing companies to create an insurance product or shop the competition for a better price. The propriety of such activities has never been challenged.

Finally, we believe the boundaries of the new set of antitrust rules must be precisely defined to avoid the uncertainty and cost of working it out through protracted, expensive litigation.

As you know, Mr. Chairman, the industry has faced unprecedented natural disasters, underwriting losses, and attention on Capitol Hill. We know there are numerous issues that you believe should be addressed, and IIAA remains open to discussing these issues with you and your staff.

Like you, we hope to put this issue behind us so that all of us can concentrate on delivering our essential products to the American people.

Thank you very much. I will be more than happy to answer any questions the committee may have.

[The prepared statement of Mr. Gustafson follows:]

Prepared Statement of Eric G. Gustafson, President, Independent Insurance Agents of America

Mr. Chairman and members of the Subcommittee. My name is Eric Gustafson. Currently, I am the President of the Independent Insurance Agents of America -- the nation's largest independent insurance sales and service organization. IIAA represents nearly 300,000 independent agents and their employees. Our members are small businessmen and women who are active contributors to their communities. I am also Chairman and owner of the Blake Insurance Agency in Portsmouth, New Hampshire.

I appreciate the opportunity to present the views of the IIAA to the Subcommittee on a subject that obviously is of vital concern to our membership, consumers, and the insurance industry in general -- modification of the federal antitrust immunity afforded by the McCarran-Ferguson Act.

We commend the Chairman for convening these hearings to address the serious and important questions raised. The insurance industry -- like all industries -- is not perfect. And the IIAA has attempted to participate constructively in discussions over the years to help spur improvements in the way the industry operates. As the legislation currently stands, however, IIAA cannot support H.R. 9.

To begin, let me explain briefly the principles that have guided our views of this legislation throughout the years. The IIAA represents independent insurance agents,

small business owners, who, by definition, represent more than one insurance company. It is important to recognize the value that an independent insurance agent brings to an insurance transaction: the value of choice. Our membership stands between insurance companies and policyholders in order to ensure that our customers have the information needed to make an intelligent choice among competing, and often complex, insurance products offered by competing insurance companies. An independent agent offers consumers the easy ability to shop among insurance companies, and the agent brings to each transaction the ability to compare and analyze competing products.

Thus, an independent agent has two main concerns, both of which reflect, as well, the concerns of the insurance-buying public. First, we have always recognized our obligation as independent insurance agents to seek out what is best for our customers. It is important that our customers have a variety of insurance products to choose from -- and that those products are not only available, but also affordable. In recent years, particularly, small, regional, or "niche" insurers have played a critical role in ensuring the availability and affordability of insurance. Agents increasingly depend upon many of these insurance companies to insure specialized risks and to serve their clients in small towns and rural areas. As companies pull out of coastal areas or other locations, agents and consumers become

increasingly dependent on the smaller insurers for markets. No change should be made that would create artificial pressures that would lead to fewer markets or less meaningful customer choice. Second, the activities of independent agents themselves should not be victim of unintended consequences. It is important that independent agents continue to be able to do what they do best -- to assist their customers when they comparison shop for insurance.

Mr. Chairman, you have put much time and effort into constructing the framework of your bill, and I know you share a strong desire to preserve markets and a role for small business people like me. Frankly, your discussions with our industry have been constructive. The IIAA stands ready to discuss your proposal and the concerns of independent agents, who deal with large and small companies, and, most importantly, consumers, everyday. As you know, however, the dual concerns I have mentioned lead us to have several problems with H.R. 9, as currently drafted.

First, modification of McCarran-Ferguson must not operate in a fashion that harms the competitive position of small or regional companies or niche players. This goal requires a recognition of the importance of trending. Trending, in contrast to historical loss information, is prospective. It permits an insurance company to get a handle on what its future losses will be -- estimates of future

claims payments. H.R. 9 creates a safe harbor for collection and dissemination of historical loss information and for determination of a loss development factor applicable to historical loss data, but permits trending only during a short transition period.

Trending produces positive results for the consumer. Reliable trending helps reduce insurers' costs and the upward pressure on prices. Accurate estimates of future payments give insurers confidence as to the adequacy of their pricing decisions, and reduces contingency factors in prices. It also helps insurers and regulators ensure insurers' solvency by accurately accounting for future costs of claims.

One of our concerns with H.R. 9 is that it will disproportionately disadvantage small competitors who simply cannot develop dependable trending data on their own. Trend analysis is a complex and expensive endeavor, requiring extensive reliance on professional actuaries. It requires collection and analysis of data regarding numerous factors that must be analyzed short term and long term, nationwide and state by state, line by line, and coverage by coverage. Large companies have the actuaries and the economies of scale to bear the added cost of performing trend analysis on their own. Many small companies simply cannot afford the associated actuarial costs, and they are particularly

vulnerable to abandonment or consolidation, if costs of doing business rise.

Even if they could absorb the costs, many companies simply have insufficient data to perform meaningful trend analysis. Insurers need a large, aggregate data base of information about past losses in order to estimate future losses. Small and niche companies, large companies that are small competitors in a given market, and any company trying to enter or establish a new market will have insufficient information of its own to properly conduct trend analysis.

Without trending, small companies and even larger companies operating in specialized commercial lines, with commensurately smaller data bases, will be competitively disadvantaged and insurance companies in general will be more hesitant to enter new markets. Both effects would adversely affect the availability and affordability of insurance.

The collection of data must also protect the ability to report data on a uniform class and territorial basis.

<u>Second</u>, no change should be made to McCarran-Ferguson that impedes the ability of agents to compare products of competing companies. Thus, of equal importance to IIAA's membership is the protection of <u>joint development</u>

<u>of uniform forms and manuals of rules and other supplementary rating information</u>. The ability of insurance companies to jointly develop comparable forms, policies and other related information benefits independent insurance agents and consumers alike. An independent agent's ability to serve his or her customer is dependent, in large part, on that agent's ability to compare competing insurance products. But comparison would be difficult, if not impossible, if common formats could not be used or if companies could not standardize information that is used by agents to classify and rate a risk.

Further, if independent agents cannot rely on a standardized manual, they will be put at a severe competitive disadvantage to the direct writers. Such manuals instruct the agent how to properly use the standardized forms; they also include supplementary rating information that facilitates an agent's ability to shop among many companies. If every company had its own manual in commercial lines, for example, agents would, as a practical matter, have to represent fewer companies and the choices available to consumers would be diminished.

<u>Third</u>, it is important that any legislation protect both voluntary and state-sponsored <u>pooling arrangements</u> that allow two or more insurers or reinsurers to provide coverages and incidental services. Some states have found it necessary

to form state-sponsored pools to ensure the availability and affordability of various forms of insurance. Commercial agents, especially, frequently work with a number of companies to establish a "package" of insurance with adequate coverage for a single risk. Both forms of collective behavior enhance availability and consumer choice and should be protected.

Fourth, we believe the "state action" doctrine should not be diminished in any way. The state action doctrine, applicable to other industries operating in interstate commerce, permits a state to restrict competition to advance the public interest. Individual states may determine what sort of cooperative insurance activity, if any, is in the public interest and avoid conflict with federal law. Without the state action doctrine, anti-rebating laws, and similar state laws regulating the relationship of agents and insurers, might be ruled illegal and other collective activities ordered by the state might come under the scrutiny of federal antitrust prohibitions. At the very least, it creates the specter of dual and conflicting state and federal regulation.

Fifth, we are concerned that this legislation may have the unintended effect of favoring direct sale of insurance over the use of independent agents by jeopardizing the activities of independent agents that serve their

customers. In particular, independent insurance agents, especially in commercial lines, are often involved in creating the individualized product that best suits the customer's wants and needs. An agent may, for example, simultaneously work with competing companies to create an insurance product or shop the competition for a better price. The propriety of such activities, to our knowledge, has never been challenged. Insurance customers will not be well-served if independent agents, for the first time, are prohibited from engaging in these legitimate agency activities. Any legislation modifying McCarran-Ferguson should, therefore, protect such activities.

Finally, H.R. 9 creates a new set of antitrust rules governing the insurance industry, including prohibitions on price-fixing, territorial and geographic allocation, tying arrangements and monopolization. The meaning of these prohibitions, as applied to the insurance industry, will necessarily be the subject of much litigation and future judicial interpretation. In our view, every effort must be made to define the boundaries of these terms and to avoid the uncertainty and cost of working it out through the courts.

* * * *

As you know, Mr. Chairman, the industry has faced unprecedented natural disasters, underwriting losses, claims and attention on Capitol Hill. We understand that there are numerous issues that you believe should be addressed, and IIAA remains open to discussing these issues with you and your staff.

Our main concerns, as noted above, are, <u>first</u>, that markets for insurance are maintained; therefore, any changes to existing law that will disadvantage small, regional and "niche" insurance companies must be avoided -- and, <u>second</u>, that no changes be made that will unintentionally hurt independent insurance agents and their customers; insurance must remain available and affordable and customer choice must be preserved.

Thank you very much. I would be glad to answer questions from the Committee.

Mr. BROOKS. First, let me assure you we believe in the State action doctrine. We say that in the bill. If they have good State regulations, none of this bill applies, as you well know.

Now, gentlemen, both the AIA and the Independent Agents say that McCarran type antitrust immunity is necessary for the preparation of standardized policy forms and for certain large-risk pooling arrangements. Would you explain why you believe these activities are important from a consumer and industry point of view?

Let's start with Mr. Vagley.

Mr. VAGLEY. I will be happy to, Mr. Chairman. I think certainly with respect to the development of policy forms, we can all appreciate the confusion that might exist among consumers if each of the 3,500 property casualty insurance companies in the country had a different automobile insurance form. It would be impossible not only to compare provisions—certainly difficult, if not impossible—but to make determinations on price comparisons as well.

So I think all of us, including groups that might be considered antagonistic to the McCarran-Ferguson Act as it exists, understand there are proconsumer aspects to the joint consumer forms.

There certainly are some risks that are too great to encompass by any single company and require pooling. They include windstorms, nuclear disasters; there are others mandated or required by State law such as residual market mechanisms to deal with adverse risks or risks otherwise not insurable in the private marketplace. Those activities would seem to promote consumer activity and informed purchases, and certainly access on the part of consumers as well.

Mr. BROOKS. You would not make it necessary that all forms be standard? If you have sophisticated insurance coverage that you were selling and that Gustafson was putting on the market, it might have to be tailored?

Mr. VAGLEY. Absolutely, Mr. Chairman.

Mr. BROOKS. Not everything is going to be one size fits all.

Mr. VAGLEY. No. As the spectrum moves from things like automobile insurance to more sophisticated coverage, those policies become more individualized, and each policy is subject to State approval under those State laws that require State approval.

Mr. BROOKS. But you have to be aware of that, of course.

Mr. VAGLEY. Yes.

Mr. BROOKS. Mr. Gustafson.

Mr. GUSTAFSON. Mr. Chairman, it has been my experience that indeed there is a great deal of differentiation on forms, particularly in the more sophisticated lines and with the more sophisticated insurers.

I would like to make the point, though, and Ms. Bingaman brought it up in her testimony, the concern that these might be anticompetitive forms, in other words, she talked about people who would want to buy grapes and they couldn't get them. I submit to you that the existence of standard forms, which provide a benchmark and provide a baseline makes it more likely that companies will be willing to deviate from that, because they know or have a better chance to know the outcome. If there is litigated language, for example, that has gone on regarding existing forms, the more the companies know about the probable outcome, the more likely

it is they are going to be willing to offer the kind of competitive products that we all talk about.

Mr. BROOKS. Mr. Vagley, America is facing fundamental competitive challenges in the 1990's in industries ranging from telecommunications to semiconductors to financial services. What competitive challenges do you foresee for the insurance industry in the global marketplace?

Mr. VAGLEY. If you are talking about international competition, Mr. Chairman, increasingly, and I think our membership reflects this to some extent, foreign insurers are finding toeholds in the American marketplace.

The American marketplace has been the largest insurance marketplace in the world and remains so. But increasingly the proportion of that marketplace compared to the world market is diminishing over time, which is causing domestic companies, American companies to seek out new markets abroad.

There are substantial trade barriers that exist in most of those countries, and a substantial part of our time is spent trying to tear down those barriers so American companies can have equal access to those marketplaces. I think those conditions can only become more exaggerated and worsen over time.

Mr. BROOKS. I would like to work with you on that particularly, because I believe in fair trade. We ought to have trade with all of our partners in the world, but we ought to be treated just the same way as we treat them. If they come in here and sell insurance or rice, we ought to be able to sell insurance or rice to them on the same basis, under the same restrictions, whatever they are, but certainly we should not be encouraging our partners in world trade to discriminate against any of our products, whether they are insurance or farm products or computers or airline connections. But they habitually do that. It is a steady fight. I will be glad to work with you on that one.

Mr. Gustafson, it is my belief that although small companies are solicited for input about industry practices by ISO, their input is not always followed. Is it possible that by opening up the industry to other information providers, small insurers may actually benefit by carrying out effective market niches and finding new customers?

Mr. GUSTAFSON. Mr. Chairman, I think first of all—I would like to believe that the agents perform a real service for the smaller companies in many cases. We take a great deal of pride in the part that we play on behalf of consumers in dealing with such organizations as ISO, and as you know, there are many others that are in the forms and rating business.

I don't think this would be a problem for the small companies. I think there is an adequate place for them to get their views known.

Mr. BROOKS. You talked about markets and marketplace problems. In your experience, where do you see the problems focused now?

Mr. GUSTAFSON. It is in a variety of ways. Certainly we heard from the previous panel about some of the larger, more regulated States seeming to have difficulties with the availability of products. Certainly that can happen in some cases. We see it in auto insurance.

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We clearly see it from time to time in the inner cities. We are now seeing the advent of the problems of catastrophes rearing their heads, and the events we are seeing unfold in the Midwest right now bring that to bear all the more.

We also see it in the sparsely populated States where there just plain aren't enough people for the larger insurance companies to make a major move to try to provide insurance where there aren't many customers.

That is the area where we see the smaller companies, the regional companies being particularly important to our members.

Mr. BROOKS. Mr. Fish, the gentleman from New York.

Mr. FISH. Thank you, Mr. Chairman.

I have a few questions, but, Mr. Chairman, in the interests of time, I will be submitting some followup questions, in writing, if that is agreeable with you.

Mr. BROOKS. Those will be written and the witnesses can submit the answers to them. This is a useful procedure.

[See appendix 1.]

Mr. FISH. Mr. Vagley, how important is trending information to AIA? Is the protection of trending information an essential part of any compromise?

Mr. VAGLEY. I think the importance of trending to companies making price determinations is really indisputable. It is important. It brings the data up to a current basis.

I think the issue really is, trending by whom? Is it trending by an independent industry organization, or trending by independent providers? I think that has been the focus of much of the debate. There is no question that trending data is important in the determination of price, but the provision of data is really open to discussion.

Mr. FISH. What about small companies who don't have the actuaries to perform it?

Mr. VAGLEY. The proponents of McCarran reform would not prevent trending from being a practice. They would argue with you that there are providers who will grow and thrive in this new marketplace for trending data, and that that data will be available to smaller companies, at least those who cannot perform their own actuarial services.

Mr. FISH. Do you think the quantity of actuaries is sufficient for the industry?

Mr. VAGLEY. I don't know that the quantity of actuaries is sufficient, but perhaps like trial lawyers, the quantity will grow to fit the marketplace.

Mr. FISH. That is another subject. What about the problem of State, "rate suppression," and the adverse effect it has on companies in certain States and regions? Could you discuss rate suppression and comment on the impact it has on the availability of insurance, both nationally and in specific markets?

Mr. VAGLEY. I think it has a phenomenal impact, Mr. Fish. We experience rate suppression in all too many States. Really, distortions of the competitive marketplace.

We are a substantially regulated industry. We are frustrated by that. It affects the profitability, the margins of the industry, it

causes the industry to make market decisions that probably reduce the availability of insurance. It is a very frustrating issue to us.

Mr. FISH. Thank you.

Mr. Gustafson, the chairman raised this issue to you, and I would like to embellish on it. On page 5 of your testimony you talk about the ongoing need for agents to have access to standardized policies and manuals. Could you describe what exactly is contained in these manuals?

Mr. GUSTAFSON. Well, Mr. Fish, the manuals give the agent the roadmap as to how they are supposed to apply the rules that are put forth, how the rates are to be applied, such things as increased limits, classifications, territorial differences, as well as how you apply the actual lost cost information that we are now given to base the premium on.

There are guideline indications that the agents are to follow; for example, in rating property risks, from a fire standpoint, the difference between frame construction, concrete construction, and so on, as to the difference it would be in the final premium charged by the company.

If we don't have a common base, again, as I mentioned before, to work from, it is virtually impossible—in talking with a customer and in talking about various possible companies that I could offer the insurance to for my client—it is virtually impossible without some roadmap to go by to know that we are talking about equal coverage and equal application of the rates that might have been determined.

Mr. FISH. Inserting the matter you just raised, typically would an agent have to refer them to more than one manual to serve a particular customer? Would he refer to many manuals?

Mr. GUSTAFSON. There may be different manuals for different lines of business, and a particular company that you deal with may have its own manual that it has put out as to how it wants to function.

What we find, though, what I find as an independent agent is that by and large these manuals are all based on at least a baseline so that when we say rating a territory, for example, at least we know what is being talked about. When we say a lost cost part of a rate, we know what it is we are talking about.

Mr. FISH. Who publishes these manuals?

Mr. GUSTAFSON. Various organizations, Insurance Services Office certainly publishes for many companies. There are other similar organizations that publish these type of manuals. And as I said, many insurance companies publish their own manuals, or more likely deviations or changes from particular parts of a given manual that is looked at more or less as a standard.

Mr. FISH. Could you comment on antitrust problems posed by these manuals? Have you ever heard of price fixing?

Mr. GUSTAFSON. I am not aware of any price fixing that has gone on. I am certainly aware——

Mr. FISH. Allegations of price fixing based on the use of these manuals by agents.

Mr. GUSTAFSON. I have never heard agents making those allegations. I am certainly aware——

Mr. FISH. Other people would make them about agents' use of these manuals.

Mr. GUSTAFSON. The only specific thing I am aware of, I suspect, as everybody is, is the Attorney General's suit that was brought some time ago. I am well aware of that.

Mr. FISH. If I have time, what impact of the recent natural disasters, hurricanes, floods, et cetera, had on the insurance industry? What has been the impact on the particular markets involved, such as South Carolina, Florida? What is the anticipated impact of the various lines of coverage on the Midwest as a result of the recent flooding?

Mr. GUSTAFSON. First of all, I can't speak to what the impact in the Midwest will be. My guess is that it will have relatively minimal impact on the property-casualty industry because of the fact that much of the damage would be flood related, which wouldn't be covered by standard policies.

I can speak specifically for the Northeast, which is where I operate, in New Hampshire and Maine, and say that already we are beginning to see insurance companies have a lack of appetite for wind and hail coverage for property that is located relatively close to the ocean, even though it is unlikely that we will have the type of hurricane that hit Florida, for example.

My members in Florida and through the Carolinas and even up into Long Island tell me that they are seeing severe dislocations of the availability of coverage, that includes windstorms, for their insureds.

So I see a great deal of disruption now, and it is particularly difficult for the agent, who must place the business with an insurance company, obviously, in order to take care of the customer's needs. It is very difficult to be in that position, not being able to get adequate coverage for a customer.

Mr. FISH. Thank you very much.

Mr. SCOTT [presiding]. Thank you very much.

I would like to thank this panel and announce that because of the upcoming vote on NASA reauthorization, there is an amendment on section 316 that we have to vote on. We will be back as soon as we can for the third panel. So we will be in recess very briefly.

Thank you.

[Recess.]

Mr. BROOKS [presiding]. The subcommittee will come to order.

The final panel is made up of, first, Mr. William Pollard, executive vice president and general manager, North Carolina Farm Bureau Mutual Insurance Co., of Raleigh. He is here to testify on behalf of the National Association of Independent Insurers, as well as several other insurance associations: Alliance of American Insurers, American Council of Life Insurance, Health Insurance Association of America, National Association of Independent Insurers, National Association of Life Underwriters, National Association of Mutual Insurance Cos., and National Association of Professional Insurance Agents.

He has more hats than I have ever heard of.

Our next witness is Michael Fusco, executive vice president and chief operating officer for the Insurance Services Office.

The third witness is Linda Lipsen, legislative director of Consumers Union. She is a recognized expert on consumer antitrust issues and has testified on this legislation before. Of course, we welcome her back.

The fourth panelist is Mr. Robert J. Hunter, president of the National Insurance Consumer Organization and one of the most widely recognized experts on consumer insurance issues. Bob is an actuary. I am glad to have you back again, Mr. Hunter.

Then we will have Mr. Rick K. Nelson, president of R.K. Nelson and Associates, Lake Forest, IL, an independent life insurance agent. Welcome back, Mr. Nelson.

The final witness will be John M. Rector, who is the able vice president for government affairs and general counsel for the National Association of Retail Druggists. Welcome back, Mr. Rector.

In view of the time and the hour and the situation we have right now, I think that the wisest thing to do would be to accept all of the statements for the record as you have them reproduced, and without objection we will do that. In addition, all members will be given an opportunity to extend written questions if they so desire.

[The prepared statements follow:]

STATEMENT OF

WILLIAM L. POLLARD

ON BEHALF OF THE

ALLIANCE OF AMERICAN INSURERS

AMERICAN COUNCIL OF LIFE INSURANCE

HEALTH INSURANCE ASSOCIATION OF AMERICA

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

ON H. R. 9

BEFORE THE

ECONOMIC & COMMERCIAL LAW SUBCOMMITTEE

COMMITTEE ON THE JUDICIARY

HOUSE OF REPRESENTATIVES

JULY 29, 1993

Mr. Chairman, Members of the subcommittee, the McCarran-Ferguson Act promotes competition and a stable, reliable marketplace, contrary to what its critics say. The McCarran Act is essential to the continuation of a healthy, competitive insurance market and should not be repealed or changed in any way. H. R. 9 would result in <u>fewer</u> companies and <u>less</u> competition, which would be harmful to insurance consumers and the marketplace. H. R. 9 should be rejected.

My name is William L. Pollard, Executive Vice President and General Manager of the North Carolina Farm Bureau Mutual Insurance Company of Raleigh, N. C., and a member of the Board of Governors of the National Association of Independent Insurers.

I am appearing here today on behalf of the NAII and the following property/casualty, life and health associations: AAI, ACLI, HIAA, NALU, NAMIC, and NAPIA.

I would like to say today, based on my firsthand experience from working in the industry for nearly 25 years, that the McCarran Act is working well, as evidenced by a fiercely competitive insurance market and a sound system of state regulation.

The insurance industry is highly competitive with nearly 6,000 life, health and property-casualty companies and about 570,000 agents and brokers.

The North Carolina Farm Bureau Mutual Insurance Company began writing business in North Carolina in 1953 and has grown to become a medium-sized company writing approximately $314 million in net premiums in 1992--writing only in one state.

The company was organized by the North Carolina Farm Bureau Federation to serve the insurance needs of farmer members who were having difficulty buying fire insurance because of the nature and location of their property. While the company has enlarged its policyholder base over the years by offering its products to other rural <u>and</u> urban citizens, its main purpose of offering reasonably priced insurance to its farm constituency has not changed. And by so doing it has fostered a stable, competitive environment for all North Carolina citizens.

Without the benefits of the McCarran Act, which allows us to use industry-wide data to compete against the larger companies and to grow, our company might not be in existence today.

All the other Farm Bureau affiliated companies across the country were organized for the same purpose as ours and operate in a similar manner. This has led to a competitive market, particularly in rural areas, as many other companies now offer their products in these areas due to the success of the Farm Bureau companies.

Likewise, many other companies, most of them NAII members, were first organized to meet a specific purpose for a particular market and similarly relied on the benefits of the McCarran Act.

Under H.R. 9 these companies would be deprived of the use of "analyzed" industry data to establish rates under H.R.9. This could lead to much uncertainty on the part of these companies and could jeopardize the service provided to their customers and to the marketplace.

The McCarran-Ferguson Act allocates power between the federal government and the states regarding the responsibility for regulation of the business of insurance. Repeal of, or changes in, McCarran will alter this allocation, replacing the current system of state regulation of insurance with a system of dual federal and state regulation. We believe the system has been working very well for nearly 50 years, and we see no need to change it.

McCarran also provides insurers with a limited exemption from federal antitrust laws, i.e. Sherman, Clayton, and FTC Acts to the extent they are so regulated by the states. McCarran does not permit boycotts, coercion, and intimidation, and the scope of the exemption itself has been narrowed considerably by many court decisions. General federal corporate laws pertaining to taxes, labor relations, pensions, and so forth apply to insurers.

The reason the McCarran Act is so vital to insurers is that insurance is a unique business. Unlike other businesses, insurers do not know the true cost of their product until after it is sold and all claims have been presented and resolved, which may be years after the sale. Insurers must make educated projections about future losses, economic factors, legal standards, and a variety of other variables, and often they must wait years to find out if they were right or wrong. As a result, insurers must act jointly to gather as much data as they can to make sure their estimates are as reliable as possible.

The McCarran Act permits joint collection and sharing of statistical data and other essential information so that companies can make intelligent predictions about possible future losses, adequately price insurance products, and maintain realistic reserves to protect company solvency for policyholders. H.R. 9 would ban or put under a cloud these and many other joint industry practices. Without reliable industry data, most companies would have to either "fly blind" in making pricing decisions or follow the lead of some large company.

Some companies could be forced to go out of business entirely or be absorbed by a larger company. Ultimately this works to the detriment of policyholders who through no fault of their own may have fewer choices in the marketplace.

We are also concerned about the fact that H.R. 9 would result in unnecessary and costly dual federal-state regulation of insurance, with no demonstrated benefits. Today, regulation for solvency and claims handling is carried out by officials closest to the consumer--at the state level. H.R. 9 would subject many vital and pro-consumer industry practices--such as ratemaking, packaging of insurance products, and pooling for hard-to-place risks--to unwarranted, duplicative federal regulation.

Insurance trade practices are pervasively regulated by the individual states. H.R. 9 while ostensibly aimed at antitrust enforcement would inadvertantly expand FTC jurisdiction in the trade practice area. This would create the potential for overlaps, duplication of effort and conflicts between state and federal authorities. This unwarranted intrusion into areas already regulated by the states is but another of the glaring shortcomings of H.R. 9.

Most problems -- availability, ratemaking, consumer complaints, or company solvency -- vary considerably from state to state and we believe it is in the best interest of the policyholders in each jurisdiction to be able to address their concerns to a regulator at that level, i.e., to the individual state regulators. I strongly believe that most policyholders in North Carolina feel this way.

H.R. 9 is so vague that we anticipate years of unnecessary litigation over its application and meaning. It is hard to imagine how this will be helpful to the industry and consumers.

In summary, the changes in McCarran proposed by the bill may cause insurance markets to shrink, reduce the number of companies, reduce competition, stifle innovation, reduce the availability of insurance to consumers, and increase consumers insurance costs. The bill would be particularly damaging to small and medium size companies, like ours, which serve millions of American consumers.

Let me conclude by pointing out that no reliable evidence has been presented to show that these changes in McCarran would make insurance more available or affordable, or that the changes would address the underlying causes of insurance rate increases. Quite the opposite could occur by weeding out many local and regional carriers. The proponents of H.R. 9 may argue that the concerns we are stating are unwarranted and such is not the intent of this bill. However, why tamper with a system that has worked well for so long, - giving stability, availability and competitiveness to this business - in order to replace it with one full of uncertainty?

Thank you for the opportunity to present our views.

STATEMENT OF MICHAEL FUSCO
EXECUTIVE VICE PRESIDENT
CHIEF OPERATING OFFICER
INSURANCE SERVICES OFFICE, INC.

JULY 29, 1993

SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW
COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES

I am Michael Fusco, Executive Vice President and Chief Operating Officer at Insurance Services Office, Inc. (ISO). I am a Fellow and past President of the Casualty Actuarial Society and a member of the American Academy of Actuaries. I am here to talk to you about the essential role organizations like ISO play in the property/casualty insurance business. This morning I will discuss:

- ISO and the products and services it provides;
- How ISO products and services benefit the property/casualty insurance industry and consumers;
- How ISO has fulfilled the promise it made in 1989, to this committee and to others, to get out of the advisory rate business; and
- Our concern that amendment of the McCarran-Ferguson Act will create unnecessary legal uncertainty, deter the lawful, pro-competitive use of ISO's products and services and, thereby, irreparably harm the already highly competitive property/casualty insurance market.

I. <u>ISO AND THE PRODUCTS AND SERVICES IT PROVIDES</u>:

Insurance Services Office, Inc. (ISO) is a non-profit corporation that makes available statistical, actuarial, policy form, and related services to any U.S. property/casualty insurer.

We are doing business -- to a varying extent -- in all fifty states, the District of Columbia, and Puerto Rico. Typically, we are licensed as an advisory organization and/or as a rating or rate service organization, and we serve as an officially designated statistical agent for state regulators. We offer insurers and producers a wide range of specific services. Let me mention some of the major ones.

Pursuant to state law, ISO serves as a statistical agent. We develop statistical plans for collecting and pooling data from our participating companies, and we submit the aggregate data to regulatory authorities as required by law. While helping companies comply with state requirements to report data, we compile, edit for quality, and combine compatible data from many companies into a statistically credible, pooled data base. I should note that no insurer has access through ISO to any other insurer's individually reported data.

We perform actuarial services. We review aggregate statistical data and develop cost-based projections of statewide average loss costs -- overall and by class and territory. We provide advisory prospective loss costs to our participating companies, each of which may elect to accept them, adjust them, or not to use them at all. ISO's actuarial analyses are produced entirely by its professional actuarial staff, in accordance with the Professional Code of Conduct adopted by the Casualty Actuarial Society (CAS) and the American Academy of Actuaries, using generally accepted actuarial procedures. These procedures are consistent with the "Statement of Principles Regarding Property and Casualty Insurance Ratemaking" as promulgated by the Casualty Actuarial Society and the Actuarial Standards of Practice adopted by the Actuarial Standards Board. At ISO, insurers are prohibited from making decisions regarding advisory prospective loss costs or any aspect of ISO's actuarial methodologies.

We develop standardized policy forms. ISO standardized policy forms and endorsements enable both consumers and regulators to make meaningful price and coverage comparisons among insurers. ISO policy forms provide a base from which insurers and producers can depart, tailoring coverage to insure unique risks or target markets. Participating insurers can, and do, compete in providing coverage enhancements.

ISO is very different from the rate bureaus of the past, which, in most instances, existed as cartels. Those bureaus were organized along local, regional and national lines. In most states, insurers were required to belong to the bureaus and were required to use the insurance premium rates and policy forms published by the bureaus. In contrast, ISO's prospective loss costs and standard coverage parts are all advisory; that is, ISO participating insurers have no obligation to ISO or any other entity to use them. No property/casualty insurer can be excluded from participating in ISO. Neither can an insurer be required to join ISO. Those insurers that are ISO participants may choose the ISO products or services they wish to purchase and may then use those products and services in the manner that best fits their individual needs.

ISO's corporate policy of non-adherence is central to its operation and is the principal, but not the only, element that distinguishes it from the rating bureaus of the past. ISO focuses on the essential task of developing reliable information to assist participating insurers in making informed, intelligent and independent decisions about the insurance premiums they charge and the insurance coverage they provide.

II. <u>HOW ISO PRODUCTS AND SERVICES BENEFIT THE PROPERTY/CASUALTY INSURANCE INDUSTRY AND CONSUMERS</u>:

ISO's information and services: (1) help reduce the cost paid by consumers for insurance; (2) make it possible for more insurers to compete in the marketplace, giving consumers greater choice; (3) enable consumers to compare the prices and coverages offered by different insurers; and (4) help to speed up the claims handling process. ISO does this in the following ways:

First, ISO reduces operating costs. ISO can provide insurers with the information and services that they need to write business at a lower cost because ISO's overhead and expenses are borne by many insurers. If each individual insurer had to produce ISO information and services itself, its costs would drastically increase because it would have to increase staffing substantially, invest in expensive equipment, and devote a lot more of its resources to such an effort. It is likely that the additional cost of doing business would translate into higher costs for insurance consumers.

Second, effective use of ISO's services permits insurers to charge lower premiums to consumers by providing insurers with credible advisory prospective loss cost information. (Prospective loss costs are actuarially established estimates of the dollars needed to cover loss payments.)

Insurers can feel more secure about their pricing decisions and can reduce the margin for error built into their rates if they can confidently predict what losses can be expected on the policies that they sell. Unlike other industries, property/casualty insurers do not know the ultimate cost of the product that they sell - the insurance policy - at the time of sale. It may take months or possibly years after the policy expires before an insurer knows the policy's costs because, at the time of sale, losses under the insurance policy have not yet occurred.

Central, then, to the process of insurance pricing is the availability of a reliable data base containing premium and loss information on similar types of insurance coverages on which estimates of loss payments can be based. No insurer has enough credible information of its own for all of the lines and the thousands of classifications of property/casualty insurance. As with all forms of statistical analysis, the larger and more consistent the statistical sample, the greater the probability that the predictions based on that sample are accurate. This "law of large numbers" means that, with a broad aggregate data base of loss experience, the analysis and prediction of expected losses would be more reliable.

Insurance statistics from many insurers are pooled and maintained by organizations, like ISO, that are regulated by state insurance departments. Insurers provide ISO with data about their own premium and loss experience, which are then combined with similar information from other insurers reporting data to ISO. In turn, insurers and government agencies are provided with aggregate information derived from the pooled data base.

Although large quantities of data are a prerequisite to a credible data base, data collection is only the first step in the process of obtaining information about the future costs of providing insurance coverage. Historical data can provide a good picture of past costs but give little information about current and future costs without additional analysis -- loss development, trend, and others -- including the use of professional judgment.

Trend analysis is an important part of that professional judgment. It is an important bridge between information about claims paid on policies in the past and the cost of current and future claims. Some people think trending losses into the future is easy. It's not. Trend analysis is not simply a matter of tacking on the economists' consensus inflation forecast of, say, six percent to last year's losses.

Trend analysis requires a careful examination of claim-severity changes over time, claim-frequency patterns over time, and changes in exposure-growth patterns. It requires the evaluation of deductibles, policy limits, non-recurring events and the propensity to litigate. It requires looking at data over both the short term and the long term. It requires looking at data countrywide and state by state. It requires looking at data line by line and coverage by coverage. It requires looking at insurance cost data and changes in external conditions -- for auto insurance, things such as changes in speed limits, road conditions, traffic density, gasoline prices, the extent of driver education and drunk-driving patterns. For just three lines of insurance -- commercial auto, personal auto and homeowners -- ISO's actuaries perform more than 3,000 separate reviews per year to estimate loss trend.

ISO's actuaries -- more than any individual company's actuaries -- are familiar with the large aggregate ISO data base needed for trend analyses. ISO's actuaries have the professional training, experience and expertise to perform sophisticated analyses and make reliable projections. For any individual company to try to replicate ISO's trend analyses would require substantial staffing, training, and systems development.

Individual insurers use ISO's trend analyses -- accept them, reject them, or modify them -- as they see fit. Companies do examine the data and assumptions underlying ISO's analyses, and may agree or disagree with ISO's selection of data, ISO's assumptions or its conclusions. But, ISO's best estimate of loss trends is useful information that contributes to individual insurers' confident, informed pricing decisions. Economists, after all, cite the availability of complete information as one characteristic of a fully competitive market.

Insurers know that the prospective loss cost information provided by ISO is produced by a staff of highly trained professional actuarial and data processing experts, and is credible, reliable information. Insurers can lower the margin for error in their pricing decisions because they are confident that the prospective cost information is reliable. This permits them to charge lower insurance premiums.

The third way that ISO products and services benefit the insurance business and consumers is by making it possible for small insurers to compete with large ones and large insurers to do business in places in which they have low premium volume or no business at all. ISO enables more competitors to compete. This benefits the insurance consumer because more competitors in the marketplace translates into greater consumer choice. ISO's information

and services reduce barriers to market entry by lowering the start-up costs of doing business. Small insurers that do not have the resources to develop their own policy forms, endorsements and prospective loss cost information can enter the market by using ISO information and services. Without ISO's information and services these small insurers might not have the resources to enter markets and to compete with large insurers.

ISO's information and services also increase competition by making it economical for large insurers with small market shares for a line of insurance to write that business. If ISO could not provide large insurers with low cost information, those insurers might conclude that it is not in their economic best interest to write insurance in markets where they have a small market share, or to enter new markets. By helping insurers enter markets, ISO helps the insurance consumer. Insurance consumers benefit when there are many insurers competing to gain market share because consumers get the most choice regarding coverage, service and price.

Fourth, ISO facilitates comparison shopping. By developing advisory common language for insurance policies (i.e., known in the industry as standardized policy forms), ISO

provides insurance buyers with the means to accurately compare the prices and coverage offered by different insurers. This common language also enables state regulators and individual insurers to access comparable statistics from insurers.

Finally, ISO's information and services help speed up the claims handling process. Common policy form language, which has been interpreted by the courts, takes on a distinct legal meaning. This legal certainty reduces the likelihood that the same issues will be relitigated over and over again.

III. <u>HOW ISO HAS FULFILLED THE PROMISE IT MADE TO THIS COMMITTEE IN 1989 THAT IT WOULD GET OUT OF THE ADVISORY RATE BUSINESS</u>:

In July of 1989, Mavis A. Walters, Executive Vice President of ISO, came before this Committee and told you that ISO would stop providing advisory rates and would phase-in advisory prospective loss costs for all lines of insurance in all states where permitted by state law. She also said that we would open ISO's Board of Directors to public participation by including up to three non-insurer members. We have kept our promises.

ISO has worked with insurers, regulators, agents, and brokers to ensure a smooth and orderly implementation of the new prospective loss cost procedures and to minimize the associated costs of transition. The National Association of Insurance Commissioners (NAIC) adopted model prospective loss cost laws and procedures. To date, 49 jurisdictions have either enacted laws or taken regulatory action to institute a loss cost system and process the number of individual insurer filings that result from the move to loss costs. We continue to actively pursue loss cost procedures elsewhere.

The conversion is nearly complete. Prospective loss cost filings have been distributed in 95% (638 of 672) of all possible ISO state/line combinations. We expect to achieve a total conversion in the very near future.

The move to prospective loss costs is a dramatic change in the way insurers determine their prices. In the absence of advisory rates, all insurers are forced to determine rates based on their own individual analysis of rate components. Instead of simply adopting or deviating from the advisory rate in effect, insurers now must:

- evaluate the ISO prospective loss costs in relation to their own experience and expectations;
- determine their own underwriting expense factors;

- determine what profit target is appropriate for them and build it into their rates;
- file and seek approval of rates by regulators where required, and defend their judgment;
- select their own effective dates; and
- distribute their approved rates to their agents.

In addition, ISO now has three public/non-insurer members on its Board of Directors. At the same time as the conversion to loss costs was announced, ISO staff's sole authority to determine ISO advisory loss cost levels was extended to determining appropriate application of actuarial methodology.

ISO's conversion from advisory rates to advisory prospective loss costs has caused, and will continue to cause, a fundamental change in the way many insurers and regulators do business. The conversion is intended to restore confidence in the competitive insurance market by highlighting, expanding and documenting each insurer's independent decision-making process and by emphasizing the fact that what ISO disseminates to insurers is advisory <u>cost</u> information, not advisory <u>price</u> information.

IV. WE ARE CONCERNED THAT AMENDMENT OF McCARRAN WILL CREATE LEGAL UNCERTAINTY AND DETER THE USE OF ISO's PRODUCTS AND SERVICES AND IRREPARABLY HARM THE HIGHLY COMPETITIVE PROPERTY/CASUALTY INSURANCE MARKET:

McCarran has been with us for nearly fifty years. During that time a highly competitive insurance market has evolved and organizations, like ISO, have evolved with it. As we approach a half-century after enactment of McCarran, we should be concerned that no action be taken that would create uncertainty and deter insurers from using the pro-competitive products and services of rating and advisory organizations like ISO.

As Professor Scott Harrington of the University of South Carolina pointed out in an article on advisory organizations:

> [T]he property/liability insurance market is characterized by vigorous competition. Not only is the market share of leading firms low in most lines of business and states, but more important, there are few barriers to entry for new firms or for firms that wish to write business in different lines and in states other than those where they already operate. There is no evidence that [advisory] rates have increased prices or profits. Furthermore, this valuable

> information does not lead to price rigidity or price fixing. In fact, because of the industry's low market concentration and few barriers to entry--and because it would be virtually impossible to enforce any joint agreement to raise prices above insurer costs--cartel behavior is highly unlikely. (Fact Versus Fiction on Advisory Rates, Best's Review, October 1989, p.58)

More recently, another commentator discussing advisory organization services observed that:

> [B]oth theory and evidence indicate that the availability of those services has increased the number of firms in the market and has increased rather than reduced competition. (Patricia M. Danzon, The McCarran-Ferguson Act, Anticompetitive or Procompetitive, Regulation, Spring 1992, p. 42)

With the full availability of advisory organization products and services, the property/casualty insurance market currently displays vigorous competition. Government sponsored studies, such as those conducted by the General Accounting Office, the Federal Trade Commission and the U.S. Department of Justice, have also concluded that the insurance industry is highly competitive.

Studies at the state level have reached the same conclusion. In 1989, after extensive investigation, including three public hearings, the NAIC issued a report that strongly endorsed the pro-competitiveness of advisory organization activities. The report states in part that "Prospective loss data ... are key to actuarially sound rate-making. Lack of access to pooled prospective loss cost data would increase barriers to entry, reduce competition, and have a disproportionately adverse impact on smaller companies." (Emphasis added)

If observers in the past found that the industry is highly competitive and that there is no evidence that advisory rates or policy forms have increased profits or prices or restricted competition, it is difficult to see how proponents of McCarran reform can criticize advisory organization services when rates are no longer being distributed.

Prospective loss costs are many steps removed from rates, which are many steps removed from actual marketplace prices. A company must first determine whether or not its loss experience is better or worse than the average experience reflected in the advisory prospective loss costs and file changes accordingly. Next, it must make individual determinations with respect to expenses and profit provisions and build these into a recommended rate

by class and territory. These individual company rates not only reflect the expected costs associated with writing a particular type of business, but, of necessity, must also reflect the additional competitive pressures of the marketplace.

We believe that repeal or substantial modification of the insurance industry's limited antitrust exemption will elevate the level of legal uncertainty with which insurers must cope, resulting only in reduced capacity, availability, and competition in the marketplace. Indeed, the unique nature of the insurance industry makes it exceedingly difficult to analyze the many practices that would be subject to antitrust scrutiny if the McCarran-Ferguson Act were repealed. Most practices would be subject to a "rule of reason" analysis, to be performed by courts, on a case-by-case basis, as the practices are challenged. "Rule of reason" cases generally entail complex presentations of statistics and expert witnesses. They are among the most difficult kinds of cases for juries (and for judges) to decide. The costs of litigating them and the chances of prevailing in them are the most difficult for even the most experienced lawyers to predict.

For insurance companies, which have had costly experiences in dealing with the risks associated with the antitrust laws, there would undoubtedly be a tendency to stop

participating even in those collective activities that would ultimately be sustained as pro-competitive under a "rule of reason" analysis.

V. CONCLUSION:

Proponents of McCarran repeal or reform should bear the burden of showing that there is a need for change and that any change they propose will help, not harm, competition in the property/casualty insurance business. I have described for you how the products and services that ISO provides to insurers help to ensure competition.

By improving insurers' knowledge of their true costs and by introducing economies of scale, ISO confers benefits to the insuring public through lower costs. The pall that would be cast over these essential operations by the repeal or substantial modification of the already limited McCarran-Ferguson exemption could be enough to severely curtail them. The result would be a disservice not only to insurers, large and small, but to the insuring public as a whole.

Prepared Statement of Linda A. Lipsen, Legislative Director, Consumers Union

Consumers Union[1] appreciates this opportunity to testify in support of H.R. 9, the "Insurance Competitive Pricing Act," and congratulates the Chairman for his inspired and determined leadership on this important consumer issue. While Consumers Union endorses an all-out repeal of the insurance industry's unjustified exemption from the antitrust laws -- the McCarran Ferguson Act of 1945 --- this legislation constructs a positive compromise by prohibiting: price fixing, territorial agreements, monopolization of markets, and tieing arrangements.

H.R. 9 is good for consumers because the antitrust laws provide an incentive for offering better insurance products and services at lower costs. Consumer organizations along with a diverse group representing the elderly, labor, business, and professional societies have long supported repeal or modification of the McCarran-Ferguson antitrust exemption. I will attach a list of such organizations for this hearing record.

Throughout Consumers Union's 57 year history, we have devoted a great deal of attention to the evaluation of insurance

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[1]Consumers Union is a nonprofit membership organization, chartered in 1936 under the laws of the State of New York to provide information, education, and counsel about consumer goods and services and the management of family income. Consumers Union's income is derived solely from the sale of Consumer Reports, its other publications and films. Expenses of occasional public service efforts may be met, in part, by nonrestrictive, noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

products in the pages of Consumer Reports. Additionally, we advocate on behalf of insurance consumers on the state level particularly in California and Texas through our state advocacy offices, before the National Association of Insurance Commissioners, and before the United States Congress.

Consumers throughout this country spend more dollars on insurance than they spend on anything other than food and housing. Not surprisingly, consumers want value for their money. Our yearly survey of readers demonstrates that due to the complexity of insurance products, the various sales techniques employed, and other factors beyond the consumer's control, the purchase of insurance is typically an uninformed consumer decision. Indeed, some insurance products are so complicated that even the sales representatives misunderstand and miscommunicate the nature of what they are selling. This is true whether consumers are buying life, health, homeowners, auto, or business liability insurance and it is true despite the enormity of the personal investment involved. To add to the confusion, federal regulators and the overwhelming majority of state regulators can do little to protect the public where the market is dysfunctional or anti-competitive.

The most effective tools for making the insurance market work efficiently--the antitrust laws--are sadly missing from the federal tool box. In 1945, Congress passed the McCarran Ferguson Act which granted the insurance industry this special immunity from the Sherman, Clayton, and Federal Trade Commission Act.

Insurance is the only industry to enjoy such wholesale immunity from these consumer protection statutes. We do not believe that there is anything so unique or peculiar about the business of insurance to allow the continuation of such an unjustified policy.

Consumers throughout this country are concerned that government, whether it be state or federal, is not adequately protecting them from market abuses. A growing cry for reform can be heard throughout the nation. When the issue of whether the insurance industry should be allowed to fix prices was put to the Texas electorate several years ago, a resounding 90.6 per cent said, "NO!" Similarly, Californians voted to rescind the state antitrust exemption for the insurance industry, when Proposition 103 was adopted. New Jersey has taken similar action with regard to auto insurance.

Insurance consumers believe that something is very wrong with the insurance marketplace. Consumers are concerned that at any time the insurance upon which they rely will be either unaffordable or unavailable. They are fearful of being canceled without cause. They are fearful that no one is watching the store---and the store is a several hundred billion dollar industry.

The insurance market for consumers appears deeply troubled. For example, many drivers pay more for auto insurance than the worth of their cars; many find the purchase of insurance totally beyond their reach. During the mid-1980's numerous professions

faced rate increases that boggled the mind. Nurse midwives, day care centers, municipalities and others who had never been sued suddenly found that insurance was not available at a reasonable price, or for some at any price. Oddly, when faced with skyrocketing premiums, insurance consumers found their prospects for obtaining insurance at more affordable rates did not improve even after extensive comparison shopping. They found that carriers in similar lines quoted the same or a similar price for the same coverage. A healthy, competitive insurance market would not have produced these horror stories. At the very least, insurers do not appear to be acting independently. If anti-competitive joint activities were made illegal under H.R. 9, we could expect to see more entrepreneurial businesses writing policies for such relatively low risk professions and much less sheep-like or "follow the leader" type behavior. As a result of the insurance industry's exemption from the antitrust law, consumers, state attorney generals and others charged with protecting consumers from marketplace abuses, are often discouraged from so much as bringing their complaints against the industry. There is no reasonable expectation a jury will ultimately resolve the dispute, pursuant to the broad exemption granted under McCarran. While H.R. 9 would not correct all the marketplace problems we see, the specific prohibitions would help eliminate the most obvious obstacles to competition.

First, the bill seeks to eliminate price fixing. Traditionally, the Insurance Services Office (ISO) an insurer-

owned and operated organization has advised companies on how much to charge for different types of liability insurance. ISO has provided insurers these rates by subjectively estimating how much the industry is likely to pay out in claims and defense fees in the future, and then adding in other subjective estimates for agents, commissions and associated expenses and a comfortable profit margin. These subjective factors have been set at levels high enough to allow all insurance companies, or nearly all to make a profit. Under this regime, inefficient companies are protected and all are encouraged to inflate their prices. Therefore, market forces are not able to penetrate.

In one of the hearings on the application of the antitrust laws to the business of insurance in this Committee, ISO announced that it would stop issuing <u>final</u> rates by a certain timetable. While the ISO missed its own deadline, such a proposal is no substitute for application of the antitrust laws in the face of anti-competitive activity. A <u>voluntary</u> policy stipulation from a trade association does not enjoy the force of law and is subject to revocation depending upon the whim of that trade association, the corresponding vigilance of the public and the ebb and flow of the political tides. The absurdity of a trade association convincing Congress that the antitrust laws should not apply to it because of some sort of voluntary agreement between its members should be obvious. The only way to eliminate or at least minimize price fixing is through the enactment and enforcement of laws with substantial damages, like

H.R. 9.

Under H.R. 9, ISO could still collect, compile and disseminate past cost data, but it could not issue final rates. Therefore, each company would be required independently to set its rates, by applying to the shared facts its own estimates and judgments concerning future inflation and litigation costs and by adding in its own expense factors and profit requirements.

In urging the passage of H.R. 9, we are asking Congress to treat the insurance industry just like any other American business. If your local grocers got together and set the same price for meat, and consulted each other over price changes and promotional prices, they could be subject to treble damage fines and potential jail sentences. But if the several hundred billion dollar insurance industry conducts itself in exactly the same manner, they call it "appropriate" joint activity. We think this special treatment should end.

H.R. 9 would also prevent insurance companies from refusing to sell a certain type of policy to a consumer unless the consumer also buys a second type of insurance. This practice is called tying. A tie-in arrangement works like this: One CU staffer insured with Hanover Insurance received a letter from his agent suggesting that he obtain a homeowners policy so that Hanover could continue insuring his car.[2] Increasingly, insurers

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[2]Tie-ins should not be confused with "cross-sell" discounts, which companies must file with state insurance departments. Under cross selling, a company encourages a policyholder to buy both policies by offering a discount on one or both of the policies.

are strong-arming policyholders to obtain such support in order to issue or even to continue an auto policy.

If the only grocery store in town conditioned the sale of deluxe boneless chicken breasts on the purchase of soup bones, such conduct would without a doubt be subject to a substantial fine. But when the insurance industry engages in the same conduct, the consumer has virtually no avenues for redress. We think this special treatment should end.

This legislation also prohibits monopolization and the practice of dividing markets or setting territories. Accordingly, it would be illegal for two companies to agree that one would sell only in one area and that the other would sell only in another area. If the neighborhood grocery store got together and carved up the meat market in your area, such behavior could be subject to fines or criminal sanctions. Why then should the insurance industry be permitted to do exactly the same thing with impunity? A division of territories can work to the advantage of each of the agreeing parties, but to the detriment of the consumer.

If it is illegal for area grocers to divide markets, fix prices, monopolize the market, and tie the sale of one product to the sale of another, it should also be illegal for competing insurers to engage in the same conduct. There is nothing so special or unique about the business of insurance to warrant the broad exemptions granted under the McCarran Ferguson Act of 1945.

In battling past efforts to repeal the McCarran Ferguson

Act, the insurance industry opponents have always argued that such legislation would not clearly delineate prescribed conduct from acceptable insurance practices. This legislation emanates clarity, by prohibiting the most egregious anti-competitive conduct.

The McCarran Ferguson Act was born when the insurance industry was young and there was an articulable rationale for permitting insurers to engage in many joint activities to discern the nature of risk. In 1993, other than nostalgia for the past, there is no compelling justification to retain such a special interest exemption from the federal competition statutes. We urge prompt passage of H.R. 9.

ATTACHMENT

GROUPS SUPPORTING REPEAL OR MODIFICATION OF THE MCCARRAN-FERGUSON ANTITRUST EXEMPTION FOR THE INSURANCE INDUSTRY

Consumers Union
Small Business Legislative Council
National Association of Attorneys General
American Association of Retired Persons
American Bar Association
American Bankers Association
AFL-CIO
American Nurses Association
Citicorp
Citizen Action
National Insurance Consumer Organization
Consumer Bankers Association
Business and Professional Women
Automotive Service Association
Consumer Federation of American
National Association of Women Business Owners
National Council of Senior Citizens
Public Citizen's Congress Watch
Amalgamated Transit Union
U.S. Public Interest Research Group
American Association of Nurse Anesthetists
American Association of University Women
Older Women's League
National Association of State Utility Consumer Advocates
New York State School Board Association
National Independent Dairy-Foods Association
National Association of Retail Druggists
National Consumers League
National Business Association
Burlington Coat Factory
Independent Agents and Brokers for Competition
Fairfax County Department of Consumer Affairs

PREPARED STATEMENT OF J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. Chairman and members of the Subcommittee, it is a pleasure to appear before you again to discuss the need for reform of the insurance industry's exemption from this nation's antitrust law.

Mr. Chairman, I would like to take this opportunity on behalf of America's consumers, to thank you once more for your tireless leadership on this vital issue. We commend you for your remarkable effort.

When I headed the Federal Insurance Administration under President Ford, the Department of Justice studied the exemption of insurance from the antitrust law and called for reform. The Carter Commission on Antitrust Laws and Procedures, in a separate study, agreed. So has the American Bar Association. So has the State Attorneys General. So has the long and diverse list of supporters for reform attached as Exhibit A to this testimony. So has <u>Business Week</u>, <u>The Journal of Commerce</u>, and the <u>New York Times</u>. (See attached editorials - Exhibit B.)

Mr. Chairman, literally decades of thought, study and debate have gone into creation of the language embodied in H.R. 9. I have witnessed the evolution of this bill over the years and believe it is now time to proceed with reform.

Who opposes reform? While all of the insurance industry opposes H.R. 9, only part of the industry opposes any sort of reform (i.e., The American Insurance Association has adopted a position in favor of a "safe harbors" bill). It is clear that

even significant parts of the insurance industry now recognizes the need for change.

As you know, three states have moved to eliminate their mini-antitrust exemptions: California (in 1988 via Proposition 103), New Jersey (for auto insurance), and Texas. California's antitrust law has applied to insurers for five years, and there are more insurers licensed to do business in the state than when the antitrust was repealed. Insurers profits have risen while prices have stayed stable. For example, California was the third fastest increasing price state in the nation before repeal, now it is third from the bottom in price increases. Insurers have managed to find the needed actuarial assistance on trend and other elements in these jurisdictions. ISO has used untrended loss costs exclusively since Proposition 103 passed in November, 1988. It performs neither loss development nor trend in New Jersey. It does not function in auto in Texas

The reliance on advisory organizations to set rates or prospective loss costs has been a costly disaster for consumers. Billions of dollars are wasted because this industry is not subject to the full forces of competition that has made other industries efficient. GAO found savings of 30% when Michigan adopted competition rather than regulation in Worker's Compensation. Savings in other lines will be less, but significant, I predict, when H.R. 9 passes. Because of their preoccupation with getting rates on loss costs high, these "advisory" organizations -- owned and operated by insurers, have

not done what they should have done to get excellent data in place. No advisory organization routinely collects data on efficacy of anti-fraud efforts, for example, and none collects data on safety or other loss prevention information. Wouldn't it be nice to see these organizations helping lower loss costs through innovative data collection rather than raising prices through innovative trending and other ratemaking techniques?

But, without H.R. 9, this won't happen. The advisory organizations' mission is to get rates up, not down. Their existence has been expensive for a long time and can no longer be tolerated in the world-wide economy of 1990s.

These advisory organizations have promised to change from ratemaking (where final rates are promulgated) to organizations of "prospective loss costs" (the whole rate, less expenses and profit, but including trend). They promised never to send out expense data again but they are doing so now. Their profit recommendation has always been a known fixed percentage, usually 5% of premium. So all the important elements of the old bureau rate are still promulgated. They also told us the change would be accomplished by 1990 (i.e., all states would be on a loss cost basis).

But they have not kept this schedule. The implementation schedule has slipped considerably and they now have reversed themselves and will send out expense circulars again. The "rate" is back in the rate bureau. The cartel does not give in easily.

The reason we need law change and not insurer promises is

not just that promises can be broken, but that America's insurance consumers look to Congress for assuring genuine lasting reform in federal policy -- reform that will allow needed data to continue to flow -- even better data, faster -- while ending price-fixing and other clearly anti-competitive practices.

I would like to take a moment to debunk a couple of the lingering myths against the bill.

It continues to be said that H.R. 9 would hurt small insurance companies. Nothing is further from the truth. H.R. 9 would hurt <u>inefficient</u> insurers, large and small, by bringing the forces of competition to bear. As an actuary, I can tell you that the actuarial profession is prepared to handle the needs of the small company. Small companies that are efficient will do just fine. You have bent over backwards to assure that by being very generous to small insurers in your bill, Mr. Chairman.

Consulting actuaries, armed with better data from today's advisory organizations will produce even better trend estimates than the rating organizations ever could. ISO has over 1500 companies that are affiliated in many lines of insurance for a total of several thousand filings. ISO has only a handful of actuaries. Do you think they give personalized trend service to each company for each line? Of course not. They make a high -- one size fits all -- trend. That's how they handle the 1500 companies' and all those lines' problems and that's why America pays too much when rates are set jointly. The ratemaker must make rates that are high enough for the highest cost number!

Another argument is that, while this change will do nothing ("we don't price-fix"), it will increase the chances of insolvency. (I find it rather amusing that the insurers constantly maintain that we do none of the H.R. 9 -prohibited practices, but to stop them will spell one sort of disaster or another.)

In fact, I believe that the lock-step rate setting nature of the advisory organizations <u>increases</u> solvency concerns. Take the "liability crisis" of the mid-1980's as a case in point. Insurers compete, at times, for commercial insurance because of the option some businesses have to self-insure. These competitive phases are called "the soft market". This is followed by a "hard market" where bureau rates or loss costs are used by almost all companies and where profits become excessive because this advice is pegged at too high a price. Near the end of the soft market, 1984 in the most recent cycle bottom, insurers compete to a level often below cost. The reason is that these insurers know that holding on to a market share is a very logical strategy given the fact that very soon rates will skyrocket to bureau levels where super-profits are routinely earned.

Thus the availability of these prices or loss costs in the market are not only a great disincentive to competition in personal lines, but also adds fuel to both the lows of the cycle bottoms and the highs of cycle tops, as well as increasing

uncertainty and solvency risk, particularly for smaller insurers who might engage in commercial insurance at the wrong time.

The recent Supreme Court decision in the Hartford Fire Insurance Co., et. al., case also makes it clear that Congress should act now to end the confusion in the current McCarran-Ferguson exemption. The fact that it took 100 pages of obtuse jurisprudence, in two 5 to 4 votes, after two lower courts disagreed totally, demonstrates that the insurance industry's special interest antitrust law exemption remains a serious hazard to America's financial health.

The Court's decision -- that, when four huge U.S. insurance companies conspire with foreign reinsurers of the size and clout of Lloyd's of London to make broad insurance coverage unavailable to businesses in the United States, there is no antitrust immunity -- was obviously correct.

But there is no question that if two butcher shops entered into the sort of anti-competitive conspiracy the defendants engaged in, they would have been slaughtered at each court, unanimously.

Individuals and small businesses are the most vulnerable to the kinds of pressure and coercion the insurers were guilty of. Hartford, Allstate, Aetna and CIGNA wanted to stop insuring businesses against pollution and other claims. But they knew they could not sell poor policies like these if other insurance companies did not do likewise. The naked attempt to squash competition that ensued was required since to do otherwise would

leave the conspirators unable to face the rigors of competitors who offered better policies. Had the Supreme Court abided this behavior, it would have made a mockery of the U.S. Antitrust law. The fact they struggled so with it is a serious wake up call to Congress that America needs to deal with the McCarran-Ferguson Act's excessive antitrust exemption.

How can you manage competition in health insurance if insurers can legally fix prices, as they may today, or collude to limit policy coverage as in this case? How can America afford a continuation of the McCarran-Ferguson Act?

H.R. 9 has my support and the support of the whole country (excluding the insurance industry) because it addresses <u>real</u> problems with <u>real</u> solutions. It ends price-fixing, that most egregious of the exemption's manifestations. It also ends monopolization of markets, tie-in sales and market allocations. I have personally seen examples of each of these abuses in insurance in American. They cost us all. They can and should be abolished!

H.R. 9 does this, and the time has come to enact it into law, Mr. Chairman. We at NICO, and the rest of those who support this bill, stand ready to do all in our power to assist you in this effort.

I would be happy to answer any questions you may have.

<u>Groups Interested in Repeal or Amendment of McCarran-Ferguson</u>

Small Business Legislative Council
Consumers Union
National Federation of Business and Professional Women's Clubs (BPW/USA)
National Council of Senior Citizens
U.S. Public Interest Research Group
American Federation of Labor -- Congress of Industrial Organizations (AFL-CIO)
Consumer Federation of America
American Association of Nurse Anesthetists
Texas, Colorado, and Illinois Associations of Nurse Anesthetists
National Insurance Consumer Organization
Consumer Bankers Association
American Association of Retired Persons
Amalgamated Transit Union
Environmental Policy Institute
Environmental Action
Public Citizen's Congress Watch
National Association of Women Business Owners
Women's Equity Action League
American Nurses Association
Association of American Physicians and Surgeons
National Association of Attorneys General
American Bankers Association
Business and Professional Women
Citicorp
American Association of University Women
National Women's Health Network
Federal Trade Commission
American Association of Colleges of Nursing
American Society for Medical Technology
Automotive Service Association
Citizen Action
American Bar Association
Society of Collision Repair Specialists (SCRS)
Older Women's League

Editorials

138 BUSINESS WEEK/APRIL 11, 1988

THE INSURANCE CARTEL IS RIPE FOR BUSTING

A smoke-filled room in which "competitors" set prices and carve up markets is the setting often associated with violators of antitrust laws. Unless, that is, the competitors belong to the $350 billion U. S. insurance industry. The 1,400 or so property-and-casualty underwriters routinely set prices, citing nationally published rates rather than establishing their own (page 60). And it's all perfectly legal under the 1945 McCarran-Ferguson Act, which circumvented a Supreme Court decision subjecting the state-regulated insurance industry to federal regulation for the first time. McCarran-Ferguson bars Washington from overseeing the insurance industry, specifically exempting it from antitrust laws.

It's high time to scrap this legislative anomaly. The fruits of joint action by the industry, ranging from sky-high premiums for day-care centers to absolute refusal to insure some businesses, are increasingly bitter. Lawmakers should adopt the bills now pending in the House and Senate outlawing the most egregious conduct of the industry while protecting the few joint activities that are beneficial. A bill pending in the Senate would permit the industry to continue gathering data industrywide, coordinating the underwriting of large risks for businesses and municipalities, and offering lines of coverage jointly for the hard-to-insure. The legislation would also let insurers establish guaranty funds to cover each other's bad debts.

But the legislation would ban the kind of coordinated action that leaves businesses without coverage, even though they have never filed a claim. The sooner Congress acts to end this cartel, the better off we'll all be.

End McCarran-Ferguson

INSURANCE COMPANIES HAVE ENJOYED for too long the protection of an antitrust exemption that permits price discussion without fear of prosecution. This immunity keeps rates artificially high, impedes competition and, industry claims to the contrary, is not essential to collect the data insurers need to chart a successful business course.

Many of the 3,500 property/casualty insurance companies in the United States are local concerns. Most insist they can write a variety of insurance lines only because they have access to historical data from an industry organization called the Insurance Services Office. That group also uses its actuarial expertise to suggest rates to its members.

Proponents of the McCarran-Ferguson Act, which provides the antitrust immunity necessary to create suggested rates, defend the system as a way of retaining the competition and underwriting capacity of thousands of companies.

But combining pricing data from well-run and poorly run companies, as the Insurance Services Office does, ultimately produces suggested rates that are higher than justified. The result is excessive insurance premiums.

One of the aims of the recent antitrust suit by state attorneys general against large segments of the industry is to break up the Insurance Services Office. Another strategy for attacking McCarran-Ferguson is evolving in the House Energy and Commerce Committee, where moves to have the federal government collect data on the insurance industry are being linked to pending legislation to reform product liability law.

Insurers steadfastly object to changes in McCarran-Ferguson or to any form of federal data collection. They insist that there is no alternative to the familiar Insurance Services Office. This stance is not only unjustifiable, but is detrimental to some insurers.

Antitrust immunity is not vital to the insurance industry. Insurers' need for data is legitimate, but there is no reason that data cannot be provided by consultants working for individual firms. On major policy issues, many trade groups in industries such as banking and steel employ economic analysts to recommend a unified course of action for the industry. The insurance industry could turn to similar sources, although pricing would be off limits.

Reducing the sharing of insurance information could result in costs that some companies could not bear. But many small businesses fail at the hands of larger competitors. It is up to smaller companies to find a service or a market niche in which they can survive.

Meanwhile, antitrust immunity gives the insurance industry a major political problem. Every issue, from product liability law reform to information gathering, becomes a fight over whether insurers are hiding something under the cloak of McCarran-Ferguson.

Competition in insurance, as this newspaper's extensive daily coverage of the industry confirms, works to the benefit not only of buyers of insurance, but of the better-managed insurers as well. Eliminating antitrust immunity is an important step in increasing that competition.

Business

ENDING AN ANTITRUST EXEMPTION

Insurance Needs a Dose of Competition

By ROBERT HUNTER and JAY ANGOFF

INSURANCE companies have been legally allowed to fix prices since 1945, when Congress passed the McCarran-Ferguson Act, which exempts the insurance industry from the antitrust laws. As a result, Americans have paid more than they should for coverage and business has been forced to suffer through periodic "crises" of soaring premiums. Now, Congress has a chance both to restore stability to the industry and ring down prices by repealing the antitrust exemption.

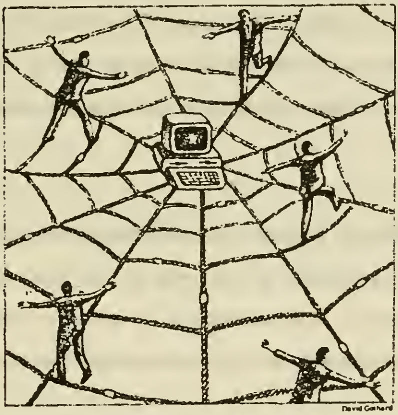
The exemption, along with fluctuations in interest rates, was a major cause of the insurance "crisis" of 1985 and 1986 and caused a similar one 10 years earlier. In these crises, insurers cut premiums when interest rates are high (since the invested premiums earn high returns) and raise premiums when interest rates are low. The sharp rise in premiums in these episodes is terribly disruptive to businesses, especially to such activities as day-care centers that find premiums shooting up by 1,000 percent or more.

But interest-rate fluctuations alone cannot explain the sharp and uniform nature of insurance rate increases at the bottom of each insurance cycle. The antitrust exemption — which allows insurers to raise their prices in concert — does.

Specifically, the antitrust exemption enables an insurer-owned organization called the Insurance Services Office to collect industry data and issue "advisory" rates, which companies may legally use as a benchmark. When interest rates are high, companies price way below the "advisory" rate. But at the bottom of the cycle, the companies return to it, as they did in 1985.

In January 1985, I.S.O.'s president, Daniel J. McNamara, told a high-level industry conference that "the need for significant premium increases, especially for commercial lines, is absolute for the next three years." Then, in May 1985, I.S.O. distributed throughout the industry a major position paper, entitled "1985: A Critical Year," which proclaimed that "the brutal price war of the last six years is over," and that "significant premium increases are needed, especially for the current commercial lines products." By the summer, premiums were soaring and the insurance "crisis" was in full swing.

Robert Hunter is president, and Jay Angoff is counsel, of the National Insurance Consumer Organization



David Gothard

IF insurers were subject to the antitrust laws, they could not call a halt to price cutting and sharply raise their prices in concert. Moreover, knowing that they could not fix prices, they would be less likely to cut prices recklessly in the first place. Because interest rates will continue to fluctuate, eliminating the antitrust exemption would not eliminate the insurance cycle entirely. But it would moderate the cycle enough to prevent future insurance "crises."

Repealing the antitrust exemption would also outlaw the industry's following anti-competitive practices:

- The requirement that workers' compensation insurers charge rates issued by the National Council on Compensation Insurance.
- The common practice, called a tie-in, of refusing to sell certain policies unless customers also agreed to purchase another type.
- The custom of publishing a list of current prices for auto and homeowners insurance by the leading insurance companies in each state, along with the I.S.O. "advisory" rate, and making the list available only to insurance companies, and not to consumers.

Although insurers cannot explain why they need the exemption, they defend their privilege in the following three ways. First, they argue that repeal would lead to Federal regulation of insurance, which is anathema to Congress. But the repeal bills expressly provide that the states shall regulate insurance.

Second, the industry argues that the exemption enhances competition by providing small companies with industrywide data on past claims. While insurers need such data to establish rates, that need does not justify an exemption for fixing prices. Moreover, the courts have clearly held that the exchange of data on past costs is lawful under antitrust law.

Finally, insurers argue that repealing the antitrust exemption would prevent them from forming pools to insure large or specialized risks. But pooling arrangements would be joint ventures under the antitrust laws, and thus clearly lawful where the combination achieves a result that the companies could not reach alone.

In short, insurance companies like their exemption for price fixing and fear losing it. (Although the ghost they really fear is the invisible hand of full competition.) But they do not need the exemption.

Insurance officials have occasionally expressed a willingness to negotiate. Robert E. Vagley, the president of the American Insurance Association, has said that the industry might forgo the exemption as long as state regulation is preserved. The former president of A.I.A., T. Lawrence Jones, has urged the industry to support limiting the exemption. Nevertheless, insurers generally argue that the industry is not broken so Congress should not fix it.

With $400 billion in sales, record profits in both 1986 and the first quarter of 1987 and with dozens of lobbyists in Washington and millions in campaign contributions, insurers expect to get their way in Congress this year, as they have in the past. But with Administration officials, Democratic leaders and a broad coalition of small businesses, banks, health professionals, consumer groups and others supporting repeal, insurer price fixing may have reached the end of the road. ■

Prepared Statement of Rick K. Nelson, Independent Insurance Agent

Mr. Chairman and Distinguished Members on the House Committee on the Judiciary, I appreciate the opportunity to testify in favor of the Insurance Competitive Pricing Act of 1993. I believe this bill will lower the cost of insurance for the average American consumer and send a strong message to the insurance industry that the public is aware of their anti-competitive behavior and will not tolerate it any longer.

I am Rick K. Nelson. I appear today as an independent insurance agent from Lake Forest, Illinois. I would like to share with you my own experience of attempting to offer lower cost insurance to consumers and the predatory actions taken by insurance companies to stop me and to prevent savings from reaching the consumer.

I began selling life insurance 18 years ago while still a student in college. three I started to build a successful business serving the life insurance buying needs of a wide range of individual consumers and small businesses. My industry involvement has included past memberships in the American Society of Chartered Life Underwriters, the National Association of Life Underwriters, the Twenty-Five Million Dollar International Forum, the Association of Advanced Life Underwriting, and I was a director of the Chicago Association of Life Underwriters. From these organizations I was able to meet and learn from the brightest and most successful life insurance sales people in the industry - the very agents who made presentations on "Estate Planning in the Forbes 400" and "Marketing Concepts for $ 25,000,000 Estates and Up".

I also learned that most of the leading life insurance companies had developed discount policies which paid a lower commission to the selling agent with the commission savings going to the consumer in the form of either a lower premium or greater cash value. These discount policies were filed with the state insurance departments

for purchase in amounts of $ 50,000 or $ 100,000, but as I learned later..... agents were discouraged from selling them when not in multi-million dollar amounts. I also knew that a FORBES magazine list of 400 multi-millionaires was a much smaller market when compared to the average insurance buying consumer. In fact, American consumers purchased more than 13 MILLION new individual life insurance policies in 1992, with first year annual premiums of more than $ 10.5 BILLION and over $ 1 TRILLION in benefits. (Source: Life Insurance and Marketing Research Association, Inc. and American Council of Life Insurance) When 1992's purchases are added to continuing policy premiums purchased in earlier years..... consumers spend more than $ 75 BILLION annually on their individual life insurance and over $100 billion on their annuities.

I developed a marketing plan to expand my business and serve more consumers. I called myself a "discount life insurance broker" and developed advertisements to inform consumers of the services that could be provided. The ads never included the name of any insurance company. Rather, they merely repeated the message of the Illinois Life Insurance Buyer's Guide as prepared by the State of Illinois Department of Insurance. The consumer should decide how much life insurance to buy, what kind and compare the relative cost of similar life insurance policies. I added to this the offer of lower commissions with discount policies.

And how did the insurance companies react to me selling <u>their</u> discount policies to the consumer? My authorization to sell the policies of Metropolitan, Prudential, and Transamerica Occidental, three of the largest companies in the industry was cancelled (copies of cancellation letters included). Over a nine month period I was cancelled every 3 months, like clockwork. The reasons for being cancelled by the insurance

companies; discount insurance, and advertisements.

Did I know that I was discounting.... absolutely yes. In fact in 1989, I engaged the services of Bruce Foudree, a Chicago attorney who was formerly Insurance Commissioner of Iowa and past president of the National Association of Insurance Commissioners. We met with the Deputy Director of the Illinois Insurance Department to review the sales material and policy descriptions provided to me by Metropolitan, Prudential, Tranamerica Occidental, and other companies (copies enclosed). The Illinois Insurance Department said the discount policies were legal because the insurance companies had filed the policies properly with the Department. It was the companies that created the discount policies. But as you now see, they obviously never intended to honor those policies.

I am licensed to sell insurance in other states and I offer a discount as provided by their state law.

Cancelling my agreements to sell their policies was only part of the industry's efforts to remove me from the marketplace. In other instances insurance agents obtained insurance quotes from me under the guise that they were consumers interested in using our services to purchase insurance. I have been told that some agents were in competition with me and wanted to have access to my quotes while other agents just wanted to create so much expensive and time consuming work for myself and my staff that it would drive me out of business.

A lost sale in the summer of 1990 was typical of insurance company and agent interference with my business. At that time I had been contacted to sell insurance to

the three owners of a small business in California. Prudential was one of the companies that I quoted and recommended. My proposal was Federal Expressed to the proposed insureds and they provided me with a phone number so that I could have them contacted to arrange the medical exams. Shortly thereafter, my phone calls to them went unanswered. This coincided with another lost sale of Prudential insurance to a consumer in the same geographic area and the outright cancellation of my agreement to sell Prudential products.

I became suspicious and decided to go to California and ask the three executives why they changed their minds and decided not to use my services. I never met the three executives and to this day I do not even know if they were real. I discovered that the address to which Federal Express delivered my quotes was the Prudential Insurance Company.

I appealed my cancellations at each company and spoke with company officers and senior management. They told me that they were aware of what I was doing, they did not like it, and they would stop me.

Buying the type of life insurance that is appropiate for each consumer's needs, understanding how the policy works, and comparison shopping are encouraged by the state insurance departments and the National Association of Insurance Commissioners. However, when I tried to provide this information to the consumer I was cancelled. I am not alone in feeling the wrath of the insurance industry for trying to give my customers a better product at a lower price, as other discount insurance brokers have been cancelled. In fact, one of the other pioneers in discount insurance has stopped all advertising because of insurance company cancellations and continued

efforts to drive him out of the industry. I have received many calls from other agents who have told me that their plans to expand the sale of discount insurance have been halted since they learned of my fate.

What did I do that was against the best interest of the Prudential? I offered their discount policies to the average American consumer. These policies do not come with a warning label: **Only sell to privileged customers in the FORBES 400, violators will have their sales agreements cancelled and business destroyed.**

In my experience, comparison shopping and discount policies reduce the cost of life insurance about 20%. That is an annual savings of several billion dollars to consumers. Who needs that savings more today - someone worth $ 50 MILLION or the average consumer?

The insurance industry complains that it cannot afford to make discounts available on the small $50,000 and $100,000 policies, only on the multi-million dollar purchases. Why? The insurance actuaries design and price the policies before they are filed with the state insurance departments; and if they are filed to be issued for $ 50,000 and $ 100,000, why can't the agent sell them?

For too long the insurance industry has hampered any efforts by agents to initiate sound and effective marketing methods to offer lower, competitively priced insurance to the consumer. If agents are prevented from informing the consumer of potential savings and assisting them in comparison shopping, then the consumer is left to be a pawn of the insurance industry and forced to make costly decisions without adequate information. Insurance is an industry whose lobbyists and concerted financial

resources are marshalled to create an illusion of being competitive and pro-consumer. In reality, it is an industry whose actions demonstrate contempt for anyone who opposes them and willful discriminatory pricing against the average consumer.

If the life insurance industry were serious about offering competitively priced policies to consumers, it would ask itself why total life insurance premium receipts of all U.S. companies in 1992 is less than the sum of new premium purchases over the last 10 years. Why does it appear that consumers are replacing the industry's entire book of business every 8th or 9th year? Are agents not being allowed to give consumers enough information to make informed purchases?

If the industry does not want any supervision by the Federal Trade Commission, why do the largest companies find the advertisements of discount insurance brokers like myself so threatening and against their best interests that they must act to cancel us and drive us from the industry?

Imagine the outrage if consumers found out that stockbrokers only offered the good investments to the rich, or if banks routinely gave depositors in certain zip codes an extra 1/2% interest on their CD's just because they were from a wealthy suburb. That type of discriminatory activity can not happen in those financial service industries because <u>they are not exempt from antitrust laws.</u>

My own experiences have taught me that fair competition is unwelcome in the insurance business. The insurance industry's broad exemption from antitrust enforcement

translates into serious harm to cost conscious consumers and to agents like me. As a messenger for the many agents that are tired of being indentured servants to the insurance companies, I encourage passage of this legislation. Passage of this legislation will guarantee that insurance will be available and competitively priced for all Americans.

I thank you for the time and I welcome the opportunity to answer any questions.

STATEMENT OF JOHN M. RECTOR

BEFORE THE HOUSE JUDICIARY COMMITTEE

ECONOMIC AND COMMERCIAL LAW SUBCOMMITTEE

JULY 29, 1993

Mr. Chairman, Members of the Subcommittee:*

I am John M. Rector. I serve as Senior Vice President of Government Affairs and General Counsel for the National Association of Retail Druggists.

The National Association of Retail Druggists (NARD) represents more than 39,000 independent pharmacies, where over 75,000 pharmacists dispense more than 70% of the nation's prescription drugs and related services. Independent pharmacists serve 18 million persons daily and provide 85% of the Medicaid pharmaceutical services. More than 60% of our members are currently involved in providing home health care. NARD has long been acknowledged as the sole advocate for this vital component of the free enterprise system. We are the only national pharmacy association with universal state association membership, including those of the Subcommittee's members.

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*Jack Brooks, (D-TX), Chairman
MAJORITY: (10-D) Jack Brooks (TX), John Conyers, Jr. (MI), Mike Synar (OK), Patricia Schroeder (CO), Dan Glickman (KS), Howard L. Berman (CA), Rick Boucher (VA), Robert C. Scott (VA), David S. Mann (OH), Melvin Watt (NC).
MINORITY: (6-R) Hamilton Fish, Jr. (NY), Elton Gallegly (CA), Charles T. Canady (FL), Bob Inglis (SC), Robert W. Goodlatte (VA), Carlos J. Moorehead (CA).

NARD members are primarily family businesses. They have roots in America's communities. The neighborhood independent druggist typifies the reliability, stability, yet adventuresomeness, that has made our country great.

Competition amongst retail pharmacies is alive and well. Competition is an incentive for efficiency and the price competition in retail pharmacy is greater than can be found among the other providers of health services. On the average, our members obtain a 2% pre-tax net profit.

As owners, managers and employees of independent pharmacies, our members are committed to legislative and regulatory initiatives designed to protect the public and to provide them a level playing field and a fair chance to compete. We appreciate the opportunity to appear before the Subcommittee to assist in the assessment of H.R.9, the Insurance Competitive Pricing Act of 1993, introduced by Chairman Jack Brooks, on January 5, 1993.

H.R.9 is the product of a long-term, thoughtful, steady, patient effort to substitute pro-consumer and pro-competitive forces for the price-fixing, tying, monopolization and market allocation currently permitted under the McCarran-Ferguson Act. Extensive hearings have revealed broad-based support for repeal of the McCarran-Ferguson antitrust exemption. In the 102nd Congress after considering a wide range of views, the subcommittee reported this legislation and the full Judiciary Committee, in November of 1991, ordered H.R.9 reported to the House of Representatives. A steady-growing consensus has developed in support of H.R.9.

Advocates include a full array of consumer, labor, business and law enforcement groups. The H.R.9 coalition members include the following:

AFL-CIO Amalgamated Transit Union American Association of
Amalgamated Transit Union
American Association of Retired Persons
American Association of University Women
American Bankers Association
American Bar Association
American Nurses Association
Association of American Physicians & Surgeons
Automotive Services Association
Citicorp
Citizen Action
Consumer Bankers Association
Consumer Federation of America
Consumer Union
National Association of Retail Druggists
National Association of State Utility Consumer Advocates
National Association of Women Business Owners
National Council of Senior Citizens
National Independent Dairy Foods Association
National Insurance Consumer Organization
National Women's Health Network
Older Women's League
Public Citizen
U. S. PIRG

We are pleased to represent pharmacy on the Coalition.

The time for action has arrived. The small business and consumer communities strongly support H.R.9. The Coalition of which we are proud to be a member has explained this priority concern to each member of the House stressing that:

> ...in this period of economic downturn, Americans cannot afford the price of exempting a major financial industry from the rules of the free market. This is a critical economic issue for Congress, and we hope we can count on your support for H.R.9 as it proceeds through the legislative process.

(See attached copy of 1991 letter to House Judiciary Committee members).[1]

This should not be a partisan issue. That is, unless supporting small business and consumer interests and preventing price-fixing, tying arrangements, and other anticompetitive activity is, in 1993, the exclusive domain of House Democrats. We doubt it.

The consensus has developed and we are united in support of H.R.9. It is important to note that H.R.9 is not an outright repeal of McCarran-Ferguson antitrust exemption. It specifically immunizes from any antitrust challenge activities which are unique and essential to the insurance industry. It also makes clear that any person providing actuarial services may do so for more than one insurer provided there is not conspiracy to restrain trade, and, it provides a transition period during which joint trending is immunized from antitrust challenge.

H.R.9 Is Important to Small Business

Small businesses have a particularly significant stake in promoting increased insurance industry competition. Typically, they operate under tight cash flow conditions within highly competitive markets. Their per-unit cost for liability insurance is significantly higher. Thus a dramatic increase in liability premiums, or the artificial increase in insurance rates that result from the insurance industry's antitrust exemption, is more onerous for small businesses than for their big business counterparts. Small businesses cannot afford to hire in-house risk management

specialists for more negotiating leverage with insurers. Nor is the amount of insurance they purchase sufficient to provide economic leverage in the insurance marketplace. Because of their comparatively small size, small businesses are forced to depend on the traditional insurance marketplace, rather than forming captives and group insurance pools, increasing their reliance on self-insurance. It has also been documented that small businesses are more vulnerable to abandonment and other insurance industry abuses.

The Small Business Legislative Council, during the past decade, has been in the forefront supporting the Chairman's campaign for fair competition in the insurance marketplace. As a SBLC board member, I have witnessed the SBLC antitrust committee, especially through its chairman, Don Randall, as a key force behind the development of the consensus for H.R.9. The SBLC strongly supports H.R. 9. SBLC is an independent, permanent coalition of 100 trade and professional associations representing the interests of more than 4 million small businesses in manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture. (See attached list of SBLC members, and an SBLC issue paper on H.R.9)[2]

America's Most Trusted Professionals Support H.R.9[3]

The National Association of Retail Druggists has long supported the repeal of McCarran-Ferguson antitrust exemption. Our members as small business persons are

as encumbered by the current permissible anticompetitive conduct, as any other small business persons.

For the community retail pharmacist, H.R.9 will also help put an end to the present ability of the insurance industry and its <u>intermediaries</u> to fix prices in pharmacy reimbursement; and to the tying of insurance to the mandatory or coercive use of mail order pharmacy, which denies <u>equal access</u> to neighborhood pharmacies by consumers.

As the percentage of prescriptions dispensed covered by insurance has increased, so has the harmful anticompetitive impact on community retail pharmacies of the insurance industry's antitrust exemption. The ability to fix prices in reimbursement rates and the ability to coerce insured consumers to forego traditional neighborhood pharmacy services and substitute out-of-state mail order houses are symptomatic of the growing impact of the insurance industry's antitrust exemption.

Equally harmful to consumers are third party insurance contracts that deny community retail pharmacists the ability to continue to serve consumers because the fixed pharmacy reimbursement is based on access to discriminatory drug manufacturer prices to which our members are denied access, even though they are willing to meet the same terms of acquisition.

Another notable untoward outcome of exempt insurance practices has been the devaluation of professional pharmacy services. The non-negotiable third party contracts usually depict coverage as for "drugs" with at best minimal, if any,

recognition of the value of or coverage for important, cost effective professional pharmacy services.

The failure to provide incentives for full pharmacy services leads to unnecessary and inappropriate prescriptions; to uncounseled prescription drug use; and to reduced patient compliance with appropriate drug regimens. In the long run, the insurance industry's "commodity only" approach to pharmacy services has increased total annual health care expenditures by billions and diminished the quality of life for covered consumers and their families.

To add insult to injury, those managing such contracts respond to cost containment pressures engendered by the escalating prices of prescription drugs established by drug manufacturers by periodically reducing payments to community retail pharmacists as if community retail pharmacists control the prices established for prescription drugs.

By recognizing consumer choice and competition as the hallmarks of cost containment for community retail pharmacy, enactment of the "Insurance Competitive Pricing Act" will help to revitalize this important segment of free enterprise system.

Not only are we forced to accept whatever reimbursement the insurance industry and its "co-conspirators" demand, but industry associations and companies characterize such reimbursement as discounts "given" by pharmacies.

Those who are familiar with the impact of the insurance industry antitrust exemption know that to characterize the reimbursement for pharmacists <u>fixed</u> by the insurance industry and intermediaries in "take-it-or-leave it" contracts as voluntary on

the part of the pharmacists is similar to characterizing the victim of an armed robbery as having donated cash to the assailant's favorite charity. It is our view that once H.R.9, the Insurance Competitive Pricing Act of 1993, is enacted, the notion of "given" will have a more traditional meaning.

In the early 1970's, your former colleague, Mr. Hungate (D-MO.) conducted one of the initial investigations by the Small Business Committee of Insurance problems unique to our market. Later, members of this committee, including Mr. Hamilton Fish, (R-NY) attempted to address retail pharmacy's unique problem through the "Prepaid Prescription Program Negotiation Act", which as an alternative to repealing the insurance industry's antitrust exemption would have leveled the playing field in our marketplace through an antitrust exemption to our community retail pharmacist members. It appeared then that what was good for the goose would be good for the gander. Of course, the time for industry specific antitrust exemptions, new and old, has long-since passed; but what is good for the goose is still good for the gander: competition assured through antitrust laws.

Clinton Health Debate Highlights Need for H.R.9

Interestingly, the health care reform debate initiated by President Clinton has highlighted the fact as the Honorable Ann Richards, Governor of Texas, noted to the subcommittee in June of 1991, that the antitrust exemption has denied the insurance industry an introduction to the "joys of competition".

In recent weeks, a number of observers have noted that to increase competition in the health care market White House officials are recommending the insurance industry be stripped of its long-standing immunity from Federal antitrust law enforcement and sanctions. (See Robert Pear, New York Times, June 22, 1993, and others in attachment.)[4] We have urged such action. We are increasingly optimistic that the White House will support H.R.9.

In this regard, it is noteworthy that in former President Bush's February 6, 1992 health care message to Congress entitled "Comprehensive Health Reform Program", at page 55, he observed:

> "PPOs, HMOs and Other Pooling Arrangements of Providers" - The emergence of managed care is creating new issues in health care. For instance, if physicians in an area band together to form a PPO, thus fostering price reductions and managed care, it may be alleged that they are nonetheless reducing the number of competitors for physician services in the marketplace. At the same time, diligent enforcement of the antitrust laws is necessary to prevent price fixing and illegal tie-ins in the provision of health care. Reducing the fear of liability for certain beneficial activities while maintaining the deterrent effect of the antitrust enforcement agencies, particularly the Department of Justice and the Federal Trade Commission.

Perhaps even the Bush White House had reconsidered the importance of applying antitrust laws to the insurance industry.

H.R.9 A Priority

The enactment of H.R.9 is our organization's number one legislation priority. At a recent NARD Legislative Conference which featured H.R.9, then HHS Secretary Sullivan, M.D., portrayed a community retail pharmacy as "the pulse of the community: a source of vital health care information, products and professional assistance, as well as the nerve center of the community, both socially and politically." The late Senator and Vice President of the United States, Hubert H. Humphrey, himself a community retail pharmacist, referred to the drug store as "a living civics lesson." We intend to leave no stone unturned in helping to assure that our members fully participate in a 1993 version of a civics lesson on H.R.9.

The insurance industry's current use of its antitrust exemption denies access for many consumers to retail pharmacies and, in turn, denies access of retail pharmacies to the insured prescription business. These anticompetitive consequences are amplified by the unique and radical price discrimination by the prescription drug manufacturers to our competitors, including mail order outfits. If left unabated, these anticompetitive forces have the potential for eliminating the life blood of our businesses; namely, access to citizens in their neighborhood.

CONCLUSION

We look forward to assisting the subcommittee in the enactment of this legislation. It is our top legislative priority and we will continue to give it priority attention.

On behalf of the Small Business Legislative Council and officers, Executive Committee, and members of the National Association of Retail Druggists, we thank you for the opportunity to appear and to continue participating in the effort to enact this pro-competitive, pro-consumer legislation.

ATTACHMENT 1

To Full
House Jud Com.

November 18, 1991

H.R. 9
S. 430
EQUAL ACCESS

The Honorable Jack Brooks
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Brooks:

We urge you to support H.R. 9, the Insurance Competitive Pricing Act of 1991, introduced by Chairman Jack Brooks which will be considered by the full Judiciary Committee Tuesday, November 19, 1991. This legislation was reported from the Subcommittee on Economic and Commercial Law by a 10-5 vote. H.R. 9 would make vital reforms in the McCarran-Ferguson Act of 1945, to protect consumers and other insurance purchasers against anticompetitive insurance practices. This legislation is identical to legislation approved by the Judiciary Committee in 1990.

The McCarran-Ferguson Act, enacted in haste during the closing months of World War II at the prompting of the insurance industry, shields virtually all anticompetitive insurance practices from our nation's fair competition laws. Thus, it is legal for insurance companies to engage in price fixing, monopolization of markets, agreements not to compete along territorial lines, and coercive tying of unrelated products. Deprived of the benefits of competition in rate setting, many consumers cannot afford or obtain needed insurance. The federal antitrust laws strictly prohibit these practices. H.R. 9 would finally prohibit them in the insurance industry as well.

H.R. 9 is the product of years of careful consideration and compromise. It would fully preserve state regulatory authority. And while it would not entirely remove insurers' antitrust exemption, it would go a long way toward protecting businesses, local governments, consumers, charitable organizations, and other insurance purchasers from the most anticompetitive insurance practices.

More than ever in this period of economic downturn, Americans cannot afford the price of exempting a major financial industry from the rules of the free market. This is a critical economic issue for the 102nd Congress, and we hope we can count on your support for H.R. 9 as it proceeds through the legislative process. For more information, please contact Linda Lipsen at Consumers Union, 202-462-6262.

Sincerely,

Linda Lipsen
Consumers Union

John Rector
National Association of
Retail Druggists

Page 2
November 18, 1991

Don Randall

Donald A. Randall
Automotive Service Association

Sara S. Nichols

Sara Nichols
Public Citizen

Robert Molofsky

Robert Molofsky
Amalgamated Transit Union

Gene Kimmelman
Consumer Federation of America

Lucinda Sikes

Lucinda Sikes
U.S. PIRG

Kurt Vorndran

Kurt Vorndran
National Council of Senior Citizens

Judy Waxman

Judy Waxman
Families U.S. A.

Cindy Pearson

Cindy Pearson
National Women's Health Network

J Robert Hunter

Bob Hunter
National Insurance Consumer Organization

Monroe G. Milstein
Chairman of the Board
Burlington Coat Factory

Janet L. Pailet

Janet L. Pailet, Director
Government and Professional Affairs
American Society for Medical Technology

Philip S. Corwin

Philip Corwin, Director and Counsel
Operations and Retail Banking
American Bankers Association

Cathy Hurwit

Cathy Hurwit
Citizen Action

Rick Kent Nelson

Rick K. Nelson
Independent Agents and Brokers for Competition

SMALL BUSINESS LEGISLATIVE COUNCIL

ATTACHMENT 2

Members of the Small Business Legislative Council

Air Conditioning Contractors of America
Alliance for Affordable Health Care
Alliance of Independent Store Owners and Professionals
American Animal Hospital Association
American Association of Nurserymen
American Bus Association
American Consulting Engineers Council
American Council of Independent Laboratories
American Floorcovering Association
American Machine Tool Distributors Association
American Road & Transportation Builders Association
American Society of Travel Agents, Inc.
American Sod Producers Association
American Subcontractors Association
American Textile Machinery Association
American Trucking Associations, Inc.
American Warehouse Association
American Wholesale Marketers Association
AMT-The Association for Manufacturing Technology
Apparel Retailers of America
Architectural Precast Association
Associated Builders & Contractors
Associated Equipment Distributors
Associated Landscape Contractors of America
Association of Small Business Development Centers
Automotive Service Association
Automotive Recyclers Association
Bowling Proprietors Association of America
Building Service Contractors Association International
Business Advertising Council
Christian Booksellers Association
Council of Fleet Specialists
Direct Selling Association
Electronics Representatives Association
Florists' Transworld Delivery Association
Helicopter Association International
Independent Bakers Association
Independent Medical Distributors Association
International Association of Refrigerated Warehouses
International Communications Industries Association
International Formalwear Association
International Television Association
Machinery Dealers National Association
Manufacturers Agents National Association
Manufacturers Representatives of America, Inc.
Mechanical Contractors Association of America, Inc.
National Association for the Self-Employed
National Association of Brick Distributors
National Association of Catalog Showroom Merchandisers
National Association of Home Builders
National Association of Investment Companies
National Association of Plumbing-Heating-Cooling Contractors
National Association of Private Enterprise
National Association of Realtors
National Association of Retail Druggists
National Association of RV Parks and Campgrounds
National Association of Small Business Investment Companies
National Association of the Remodeling Industry
National Association of Truck Stop Operators
National Chimney Sweep Guild
National Coffee Service Association
National Electrical Contractors Association
National Electrical Manufacturers Representatives Association
National Fastener Distributors Association
National Food Brokers Association
National Grocers Association
National Independent Flag Dealers Association
National Knitwear & Sportswear Association
National Limousine Association
National Lumber & Building Material Dealers Association
National Moving and Storage Association
National Ornamental & Miscellaneous Metals Association
National Paperbox Association
National Shoe Retailers Association
National Society of Public Accountants
National Tire Dealers & Retreaders Association
National Tooling and Machining Association
National Tour Association
National Venture Capital Association
Opticians Association of America
Organization for the Protection and Advancement of Sma
Telephone Companies
Passenger Vessel Association
Petroleum Marketers Association of America
Power Transmission Representatives Association
Printing Industries of America, Inc.
Professional Plant Growers Association
Retail Bakers of America
Small Business Council of America, Inc.
SMC/Pennsylvania Small Business
Society of American Florists
Specialty Advertising Association International
The Council of Growing Companies
United Bus Owners of America

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SMALL BUSINESS LEGISLATIVE COUNCIL

SBLC: A UNIFIED FORCE FOR SMALL BUSINESS

The Small Business Legislative Council (SBLC) is an independent, permanent coalition of trade and professional associations that share a common concern for the future of small business. The purpose of SBLC is twofold: to consolidate the strength and maximize the influence of small business on legislative and federal policy issues of importance to the entire small business community; and secondly, to disseminate information on the impact of public policy on small business.

Since its creation 1976, SBLC has grown dramatically to represent nearly every sector of our economy including manufacturing, retailing, transportation, distribution, professional and technical services, agriculture, and construction. The SBLC now has nearly 100 member associations. SBLC has become a unified force that is respected throughout the government. The Council's views are sought and its opinions are valued by those in government who must decide how the laws of this nation are enacted and enforced.

Because SBLC is concerned with the small business community as a whole, the issues on which the Council acts are those which affect all small business. These matters include taxes, liability insurance, budget, antitrust enforcement, employment issues, government procurement, environment, establishment of a small business voice in Washington, venture capital and other small business financing mechanisms... The list is potentially endless, and it is being expanded constantly as SBLC members discover that many of the problems of their members are shared in common by smaller businesses in other industries. Any issue which is important to small business in general is important to SBLC.

In the 100th Congress, SBLC testified frequently before Congress on a myriad of subjects. SBLC was particularly concerned over efforts to impose new responsibilities on employers. Among the issues of high visibility: mandated health insurance, mandated leave, minimum wage and occupational disease risk notification legislation. At the same time, SBLC pushed for positive initiatives such as product liability reform and prohibitions on unfair competition.

With a diverse association constituency, SBLC is unique. We bring to the table consensus opinions and information that reflect both the diversity of our membership and the commonality of the small business perspective.

1025 Vermont Avenue, N.W., Suite 1201, Washington, DC 20005
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SMALL BUSINESS
LEGISLATIVE
COUNCIL

ISSUE

Insurance Industry Reform

STATUS

Legislation, H.R. 9, has been introduced by Representative Jack Brooks (D-TX), Chairman of the House Judiciary Committee, to revise the antitrust exemption granted to the insurance industry.

IMPACT/ANALYSIS

Since the last affordability/availability crisis suffered by business in securing property/casualty insurance, the small business community has actively pursued a multi-faceted agenda to ensure future crises did not occur in what has been a cyclical pattern. To break the cycle, small business has pursued both civil justice reform (tort reform, product liability reform), as well as insurance industry reform.

In the area of insurance industry reform, the focus has been on the ability of the insurance industry to operate without regard to federal antitrust law or federal regulation. The exemption was granted to the industry more than 50 years ago by the McCarran-Ferguson Act.

Small businesses have a particularly significant stake in promoting increased insurance industry competition. Small businesses typically operate under tight cash flow conditions within more highly competitive markets. The per-unit costs of insurance is significantly higher for small business purchasers of liability insurance. Thus, a dramatic increase in liability premiums, or the artificially higher insurance rates that result from the insurance industry's antitrust exemption, are more onerous for small businesses.

Smaller firms cannot afford to hire in-house risk management specialists who have more negotiating leverage with insurers. Nor is the quantity of insurance purchased sufficient to provide economic leverage in the insurance marketplace. Because of their comparatively small size, small businesses are forced to depend on the traditional insurance marketplace. Forming captives and group insurance pools, increasing their reliance on self-insurance, and taking advantage of other alternatives that lower their rates and/or provide more favorable policy terms and conditions, are generally not viable options for smaller firms.

During the most recent insurance crisis, there was evidence that some major insurance carriers abandoned the small business market. In some instances, they apparently refused to underwrite such business liability and, in other cases, they established minimum premium levels so high, coverage essentially was eliminated.

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The Insurance Services Office (ISO) is an insurer-funded rating bureau which issues a so-called "advisory" rate for different types of liability insurance. In some states, this is a pure premium rate, i.e., the portion of the premiums that ISO predicts will be necessary to pay claims. In other states, ISO issues a final rate which uses the pure premium as a starting point. To it, ISO adds expense and profit factors, including future inflation levels, size of jury verdicts, and other trending factors. Whether pure premium or final, these ISO "advisory rates" are filed with each state insurance department, and each insurance company may legally charge what ISO "advises." Some assert the ISO advisory rate is set high enough to protect the least efficient carriers and to enable the more efficient carriers to earn far higher profits than otherwise would be available. It should be noted, however, that the industry has voluntarily taken steps to limit the ISO's role in rate-making.

The current legislation would revise the scope of the McCarran-Ferguson exemption. The states would continue to have the authority to regulate the industry. The legislation makes it clear all insurance companies, from the smallest to the largest, can legally have access to the identical data base -- industry-wide historical loss data. It permits all companies to jointly "develop" industry-wide historical loss data -- to estimate how much will ultimately be paid out on the prior year's policies. From a period of five years from the date of enactment of the bill, it permits small companies to jointly "trend" the developed historical loss data -- to jointly estimate the future inflation rate, future rate of case filings, future size of jury verdicts, and other factors in order to predict how much they will eventually pay out on future years' policies. A "small company" is one having less than $20 million in annual premiums. Because more than 50 percent of all insurers write less than this amount, the definition provides a substantial benefit to a majority of companies in the industry. Small companies together account for only 2 percent of all premiums.

For competition to work, each insurer must exercise its own judgment about the future inflation rate and other future changes, i.e., it must do its own trending. Actuaries have testified that, even for the smallest insurer, the cost of hiring an actuary to trend data would be less than one-tenth of one percent of its annual premium. Nevertheless, in response to arguments that small companies may not be able to afford to hire actuaries to trend data, the legislation provides for a five-year transition period, during which they may jointly trend such data while they gradually adjust to the new competitive environment.

OUTLOOK

No specific action is scheduled.

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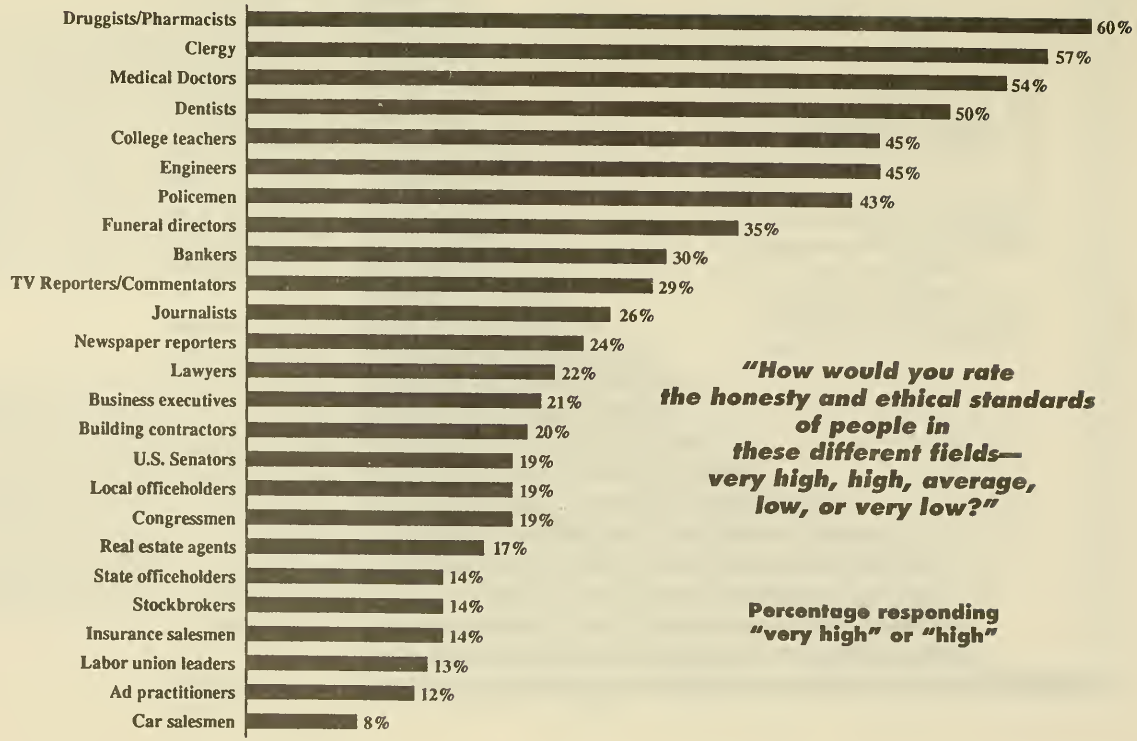
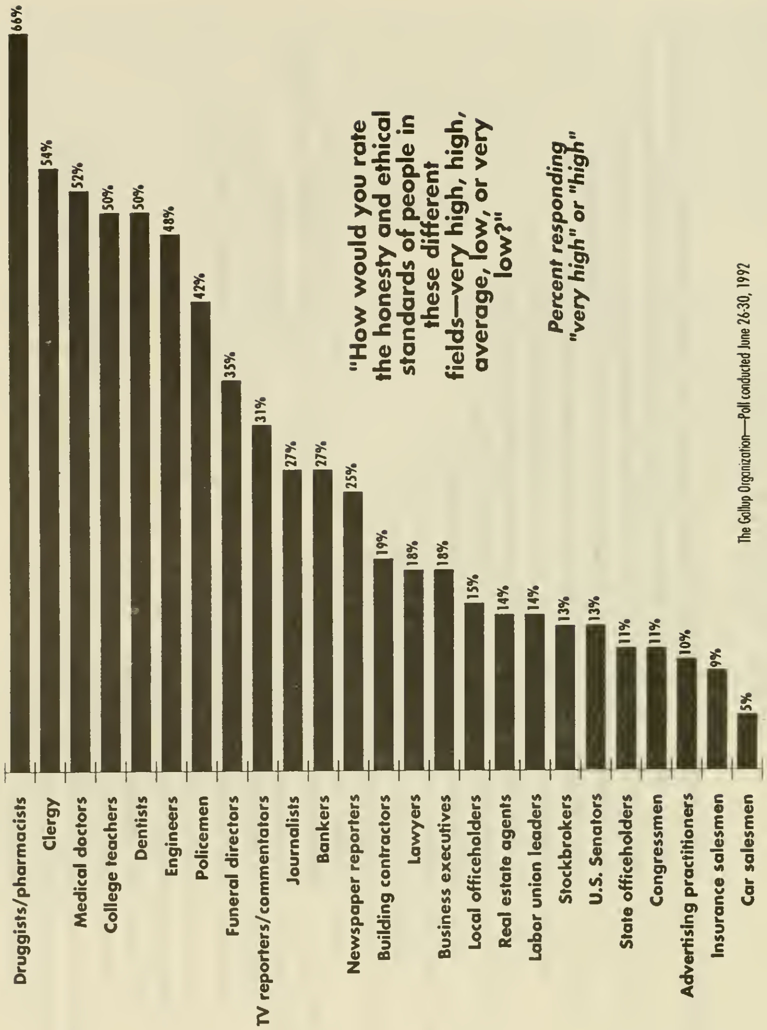
ATTACHMENT 3

1991 Gallup Poll




"How would you rate the honesty and ethical standards of people in these different fields—very high, high, average, low, or very low?"
Percent responding "very high" or "high"
Druggists/pharmacists 66%
Clergy 54%
Medical doctors 52%
College teachers 50%
Dentists 50%
Engineers 48%
Policemen 42%
Funeral directors 35%
TV reporters/commentators 31%
Journalists 27%
Bankers 27%
Newspaper reporters 25%
Building contractors 19%
Lawyers 18%
Business executives 18%
Local officeholders 15%
Real estate agents 14%
Labor union leaders 14%
Stockbrokers 13%
U.S. Senators 13%
State officeholders 11%
Congressmen 11%
Advertising practitioners 10%
Insurance salesmen 9%
Car salesmen 5%
The Gallup Organization—Poll conducted June 26-30, 1992

THE NEW YORK TIMES NATIONAL TUESDAY, JUNE 22, 1993

ATTACHMENT 4

INSURERS MAY FACE GREATER SCRUTINY

President's Health-Care Plan May Strike at Exemption From Antitrust Laws

By ROBERT PEAR
Special to The New York Times

WASHINGTON, June 21 — To increase competition in the market for medical care, White House officials are recommending that the health-insurance industry be stripped of its long-standing immunity from Federal antitrust law.

The proposal reflects the concern of Administration officials and consumer advocates who fear that a handful of big insurance companies may soon dominate the industry, especially if Congress approves the plan Mr. Clinton is developing to overhaul the nation's health-care system.

Under the Clinton plan, to be sent to Congress later this year, consumers and small businesses would band together to buy coverage from large networks of doctors and hospitals. Many networks would be organized by insurance companies.

"You don't want a cartel of insurers to be able to set prices or limit the terms of coverage free from antitrust scrutiny," said an official who has worked closely with Hillary Rodham Clinton in developing the Administration's proposal. Mr. Clinton is expected to make the antitrust proposal part of his health-care plan.

'Practices Are Shielded'

Linda A. Lipsen, chief lobbyist for Consumers Union, endorsed the proposal. "We have been opposed to the antitrust exemption for years," she said today. "Health-insurance companies decide not to provide coverage for people in certain ZIP codes. They decide what diseases will be covered and which ones won't. But these practices are shielded from antitrust scrutiny."

Insurance companies generally want to retain the antitrust exemption, but some say they are willing to consider changes, if they can share data on claims and continue some other joint activities.

In the 1992 Presidential campaign, Mr. Clinton said he would "take on the big insurance companies." But big insurers see a potentially lucrative new market in the health plan emerging from the White House.

Five big insurers, Aetna, Cigna, Metropolitan Life, Prudential and Travelers, have formed an alliance to promote the idea of managed competition, which is at the heart of Mr. Clinton's plan. In theory, under this plan, doctors and hospitals would cooperate within a network, and the networks would compete with one another.

Central Role Foreseen

"We expect to have a central role in forming these networks," said Lawrence P. English, president of the Cigna Employee Benefits Companies, a division of the Cigna Corporation. "We intend to employ physicians, have an ownership interest in hospitals and run the networks through which health care is delivered in markets all over the country."

White House officials and many insurance executives predict that Mr. Clinton's plan will lead to consolidation in the health-insurance industry, as scores of smaller companies merge or fail.

The insurance business has been largely exempt from Federal antitrust law since 1945. The Supreme Court ruled in 1944 that insurance was interstate commerce subject to Federal antitrust law. But the insurance industry won a reprieve nine months later, when Congress passed the McCarran-Ferguson Act.

Congress intended to give the industry a temporary three-year exemption. But courts have interpreted an ambiguous section of the 1945 law as perpetuating the exemption.

Little Competition Seen

Insurers won the exemption by arguing that they faced financial ruin if subjected to antitrust laws, saying they needed to be able to pool data on claims and losses to calculate rates properly. Since then, insurance has been regulated almost entirely by the states, and the quality of supervision varies.

In a recent report, the House Judiciary Committee said, "Lax oversight of the insurance industry, coupled with no possibility of antitrust enforcement, has led to the proliferation of anticompetitive practices." State officials told the committee that the 1945 law had bred a culture of collusion, leaving insurers free to fix rates, carve up markets, restrict coverage and insist that consumers buy products like prescription drugs from selected suppliers.

Insurers deny engaging in such practices.

Many of the companies want to retain the antitrust exemption. Russel P. Iuculano, vice president of Metropolitan Life, said, "MetLife opposes any legislation to repeal or modify the McCarran-Ferguson Act."

Hospitals and doctors have asked Congress to relax antitrust laws to let them collaborate. Mrs. Clinton's task force agreed that doctors and hospitals should be given clearer guidance from the agencies responsible for antitrust enforcement, the Justice Department and the Federal Trade Commission. But it concluded that there was no need for Congress to amend the antitrust laws to permit greater collaboration by doctors and hospitals. Administration officials said this guidance could be provided through policy statements and swifter replies to hospitals seeking advice on mergers, joint ventures and other matters.

THE NEW YORK TIMES, SUNDAY, JULY 11, 1993

Health Reform Runs Antitrust Risk

By LEONARD ORLAND

UNWANTED side effects are the bane of medicine, and they may bedevil the Clinton health reform effort, too. As policy makers cure health care's inaccessibility and high cost, they may unwittingly create new ailments in the area of antitrust.

These risks are real. While the specifics of the "managed competition" reforms are unknown, the Administration has embraced general principles that may dangerously increase the economic concentration of the health-care industry. There will be fewer, and bigger, buyers of health care, sellers of health care, and insurers:

Item. The reforms will organize individuals and all but the largest employers into hug purchasing cooperatives that, in theory, will force insurers to compete hard for business.

The notion sounds good — although the performance of such volume buyers as the United States Government and Empire Blue Cross and Blue Shield hasn't exactly proven the proposition. But what about the vastness of these cooperatives, which sometimes will cover a whole state and include millions of people? These single buyers — monopsonies — can be as economically dangerous as the more familiar monopolies, or single sellers.

Under reform, health entities will be bigger, fewer, more powerful.

Item. Only big sellers can meet the needs of big buyers. For this reason, under reform most of the multibillion-dollar health insurance market will go to the biggest insurers — Aetna, Cigna, Metropolitan Life, Prudential and Travelers.

Known as the "Gang of Five," these huge companies have formed an alliance to promote managed competition. Why? The companies' annual reports explain.

Managed competition is "one of our most attractive [profit] opportunities," says the Travelers report. Cigna's report sees prospects for "improved revenue growth and better margins" in light of the "new Administration's health care policy." These and the other big insurers are optimistic because they know that in the world of reform many smaller insurers, unable to service the big buyers, will fail. This will leave the large insurers with a powerful oligopoly.

THE reforms will concentrate health-care power in many other ways. To become more efficient and more able to handle large buyers of insurance, for instance, doctors and hospitals will form provider networks. In turn, many of these networks will link up with the large insurers, thus forming even larger entities. (Indeed, Cigna is already assembling a network in the New York area.) Finally, for administrative services, many purchasing cooperatives and big corporate insurance buyers will turn to the big insurers — and create still-larger groups.

In short, under reform big and few will replace small and many.

The Administration is not unaware of this dangerous convergence of power. In mid-June, it recommended that health insurers be stripped of antitrust immunity, something they have enjoyed since passage of the McCarran-Ferguson Act in 1945. Also, the Administration thus far has rebuffed doctors, hospitals and pharmaceutical companies who have requested similar immunities.

But policy makers must be even more sensitive to the antitrust dangers of health reform. First, they must realize that economic concentration is dangerous even if antitrust immunities are not granted. Such concentration is inherently dangerous because, "like all power, it is laden with the possibility of abuse," in the words of Irving Kaufman, the eminent Federal judge.

Second, as they focus on cutting health costs and raising accessibility to health care, policy makers must closely examine their proposals' antitrust effects. Are there equally effective reforms that avoid dangerous concentrations of power? Are there safeguards that can put in place? How, in detail, will this brave new world of health care be regulated? Who will oversee the regulators?

For example, the purchasing cooperatives may well receive some form of antitrust immunity because, as single sellers in a defined area, they can hardly function without immunity. If so, policy makers must be aware that the giant insurers are likely to become the cooperatives' administrators. As such, the insurers may benefit from this immunity even if their own has been stripped away.

If health reformers are vigilant, perhaps they can steer clear of the dangers that so justifiably worried Senator John Sherman when he drafted the nation's basic antitrust law more than 100 years ago. Health reform should not be a cure that creates another disease. ■

Leonard Orland is a professor of law at the University of Connecticut in Hartford.

Monopoly Medicine?

"Integrated" health plans, which tie together doctors, hospitals and other services, are being touted as a remedy for the nation's ailing health system. But in Minnesota, where such plans are relatively well established, a side effect has appeared: a rash of mergers and acquisitions that could undermine competition in the health care market.

BY JULIE KOSTERLITZ

MINNEAPOLIS—It's just another forgettable office park, stuck between the shop-till-you drop Mall of America and the airport on the southern rim of the beltway. But lately a crowd of out-of-town journalists and corporate officials has been flocking to the headquarters of the Business Health Care Action Group to learn about a far-reaching experiment in health care finance and delivery.

The group, composed of 16 large local employers, is working with a consortium of clinics and health maintenance organizations (HMOs) to devise a new kind of health care plan. The consortium has promised not only to keep a lid on employee health care costs but also to provide state-of-the-art information systems and quality controls to assure employers that they're getting the most bang for their buck.

The venture is the latest innovation incubated by a metropolis known as a leader in the health care arena. The 2.5 million inhabitants of Minneapolis-St. Paul accepted HMOs long before most Americans did. Today, about 44 per cent of local residents belong to HMOs, compared with 16 per cent nationally. During the 1980s, as the nation stewed about rising health care costs and the need to "manage" care, the Twin Cities boasted employee health insurance premiums 15 per cent below the national average. To many health care reformers, that exemplified the kind of competitive marketplace they wanted to see nationwide.

But there's been a side effect from the Twin Cities' experience: a wave of health care industry mergers and acquisitions that, some critics warn, could undermine competition. Last year, two of the area's four biggest hospitals announced a merger. In March of this year, two of the four HMOs that dominated the local market announced that they were merging.

Consolidation in the health care industry has been taking place across the country, and many experts say that's a good thing. Besides eliminating costly duplication, they say, a shakeout might promote better coordination of care. Health reformers in Minnesota and elsewhere are trying to encourage "integrated" health systems that cover all of a patient's needs, from prevention through hospitalization. Several states are passing laws to create special antitrust exemptions for health industry mergers. Hospital and physician groups are pushing for relaxation of the federal antitrust laws, a move they say will ease the transition to more-efficient, integrated systems of care.

But in the Twin Cities, some critics argue that consolidation has gone too far. "I worry that the state is not going to be able to get the benefit out of vigorous competition because there are fewer players competing," said Allan Baumgarten, associate director of the Citizens League, a local watchdog group.

It's not just the number of hospitals or health care plans that's a worry. Because "integrated" plans can be expensive and difficult to put together, consolidation could squeeze out the start-up ventures that economists consider key to the vitality of the marketplace. Government regulations may add extra hurdles for newcomers. The nation's biggest health insurers have already moved decisively into the managed care business, which could further stack the odds against smaller local ventures.

The big purchasers of health care—employers and the government—don't seem alarmed by the consolidation among health care providers. But some experts worry that the trend toward monopoly may eventually be the downfall of any health care reform plan that relies on competitive markets, if buyers and the government aren't careful.

"All of this reform is going to force a degree of consolidation that's unprecedented," said Robert E. Bloch, a Washington partner in the Chicago-based law firm of Mayer, Brown & Platt and a former chief of the professions and intellectual property section in the Antitrust Division of the Justice Department. "One of the questions is whether [reform] sets in motion a course of events that is initially beneficial, but that over time we are not able to control, once those markets

consolidate and excess capacity is removed."

Ira C. Magaziner, director of the White House health care reform task force, sees the potential for local market domination by large national firms. "All businesses want to become an oligopoly if you let them," he said in an interview. Special efforts will have to be made to ensure that new competitors will enter the fray, he said. Among the possible measures: repeal of the McCarran-Ferguson Act, which now exempts insurance companies from federal antitrust laws. (A working group within the task force has recommended repeal of McCarran-Ferguson, but the White House has not signed off on the proposal.)

But without a delicate balancing act by policy makers, reform based on competition could eventually degenerate into a tug-of-war pitting purchaser cartels against supplier cartels—with risks to consumers no matter who wins.

In that respect, the Twin Cities may be more of a trendsetter than even their boosters like to think.

JOINING FORCES

Minnesota has long led the country in embracing managed care and competition in the health care marketplace. Doctors in the state had a tradition of joining large group practices such as the Mayo Clinic, and thanks partly to a group of visionary local health experts, these clinics began experimenting with HMOs and other innovative care delivery arrangements. Paul Ellwood, a physician who helped devise the "managed competition" concept that has dominated the recent debate over national health care reform, became persuaded from his experience running a rehabilitation institute in the Twin Cities in the 1960s that conventional fee-for-service medicine resulted in unnecessarily high costs and haphazard care. Ellwood and Walter McClure, a physicist-turned-health-care-expert, started a Minnesota-based think tank that promoted the idea of competition in the health care market.

By the late 1970s, the Twin Cities seemed to have the kind of competition between managed care plans that Ellwood and McClure envisioned, said Roger Feldman, a professor of health care economics at the University of Minnesota's Institute for Health Services Research. "Many employers offered multiple health plans, including HMOs, and attempted to promote price-conscious employee choice among those plans," he wrote in a paper that is soon to be published in the *Journal of Regulatory Economics*.

The competition only seemed to get tougher during the 1980s, when large purchasers began using their market clout to demand more price concessions and greater efficiency. Doctors, hospitals and HMOs felt the squeeze: At least 10 local hospitals closed during the decade, usually after merging with others. Two pairs of HMOs merged. Doctors in traditional private practices also got pinched.

Steve Wetzell of the Business Health Care Action Group
Would-be reformers have beat a path to his door in Minneapolis.

Minneapolis internist Ronald Vessey said the income of the senior physicians in his small clinic dropped 40 per cent from 1981-91. They now earn less than $100,000 a year apiece.

But employers and government officials only grew more frustrated as health care costs continued to run far ahead of inflation. Discounts and managed care sounded good, but no matter what employers tried, "all we saw was a continuation of business as usual," said Fred Hamacher, vice president for compensation and benefits at Dayton-Hudson Corp., a Minneapolis-based retailing chain. "You might have had a slight savings for a year or two, but it didn't take long for that to be wiped out and to be back on the same old track."

Employers and the state government decided to take more drastic measures to get costs under control—measures that would touch off yet another round of mergers and greater consolidation.

In early 1992, the employers decided to join forces to increase their market clout. Dayton-Hudson and more than a dozen other Twin Cities-based employers—including Cargill Inc., Ceridian Corp. (formerly Control Data Corp.), General Mills Inc., Honeywell Inc. and Pillsbury Co.—banded together to shop for health coverage for their more than 125,000 workers, retirees and dependents.

This time, the employers weren't merely seeking discounts or managed care, but instead a fundamental change in the way care was delivered. The only way to achieve this, they decided, was to form a relationship directly with doctors and hospitals, rather than leaving the job to middlemen such as insurance companies or HMO management. They also wanted a better accounting of what they were getting. "With all of the plans we historically offered, we never knew what we bought," Hamacher said. "We didn't know what quality we were getting, and we had no idea how efficient [the delivery] was."

It was a tall order that few local health providers could meet. Earlier this year, two large HMOs, Group Health Inc. and MedCenters, decided to merge to make a successful bid for the employer group's business. The new plan, called Health Partners, also signed contracts with several large clinics, including the Mayo Clinic, to meet the group's needs.

Health Partners is supposed to develop plans to elevate the standards of medical practice and to measure and report the results of the care it delivers. For example, it will track the percentage of children who are immunized and the share of births by cesarean section. In fact, the employers' group and the new health plan have set up a $7 million research institute to help further measure and refine the medical practice of doctors.

Other large purchasers have begun flexing their muscle: A group of 400 small employers recently signed up with a new health care network put together by Prudential Insurance Co. of America.

Minnesota's state government, already a major purchaser of care for its employees, has begun organizing purchasing pools for other employers. It has created such a pool for local governments in the state and plans to create others for small businesses and for low-income individuals who don't qualify for medicaid.

Minnesota has passed legislation that is likely to produce even more consolidation in the health care industry. Like most states and the federal government, Minnesota was grappling with the problem of expanding health care coverage to

the uninsured while getting a grip on soaring costs. The Legislature expanded coverage for the uninsured. But it also passed a law earlier this year that calls for trimming the growth in health care spending in the state by at least 10 per cent in each of the next five years.

"What drove the Legislature," said Mary Jo O'Brien, the state's deputy health commissioner, "was a look at the projections of what we'd be spending in five years and at the end of the century. We said, 'Whoa. . . . we can't afford it.' "

Like private employers, state officials had concluded that the only way to cut costs was to change the way care is delivered. And so the new law contains strong incentives for doctors and hospitals to form what it calls "integrated service networks"—health plans that offer complete care for a fixed price. "Now you'll get paid on per capita basis and make money by keeping people healthy, not by treating illness," O'Brien said. "We're changing the incentives and the way we pay for health care."

Doctors and hospitals that aren't in the networks will face strict price controls and other regulation. The networks, by contrast, will be subject only to an over-all limit on cost growth. The law has touched off a mad scramble by doctors and hospitals to affiliate with one another and form networks. "We'll be history by the end of the year," Vessey said of his small group medical practice, which has existed since 1916. "There's no question we'll sell our practice or be bought out." The law has also spawned efforts by specialists, who are now considered in oversupply for a system that will focus increasingly on preventive and primary care, to band together and sell their services as a group to networks.

Hospitals have also joined the fray: Two major hospital chains, Health One and Life Span, combined to form Health Span. "We came together to better position ourselves for the future, because we think that the future is looking forward to health care systems able to provide a continuum of care to defined populations," said Brian J. Osberg, the managed care officer for the merged corporation. Two children's hospitals have been discussing a merger as well.

COLLABORATION V. COMPETITION

The move toward larger integrated health care systems has been applauded in many quarters. "The health care system is transitioning right now from a cottage industry to a business," Dayton-Hudson's Hamacher said. "Nothing is efficient in a cottage industry."

But some of the horizontal mergers between similar providers have met with suspicion that they were intended to defeat competition rather than to promote efficiency.

Minnesota Attorney General Hubert H. Humphrey III brought charges in federal court that the Life Span-Health One merger violated federal antitrust laws. (The Bush Administration Justice Department had looked into the matter but decided not to pursue it, and although Clinton Administration officials have made no public comment, people familiar with the case say the new Administration is unlikely to reopen it.)

University of Minnesota's Roger Feldman
Health industry mergers could be bad news for consumers.

"A market can get so concentrated, have so few players, that consumers suffer. Tacit or overt collusion becomes possible," said John Docherty, special assistant attorney general in the state antitrust division. Based on an analysis of the merged hospitals' combined market share (together, they control 28 per cent of the local market) and extensive interviews with employers and health care providers, Docherty said, "we became certain that [the merger] would facilitate the chain to stick it to payers, to say, 'Here's our price, take it or leave it.' "

But before the case was resolved, the state passed legislation that gave the state health commissioner the power to grant exceptions to the antitrust law. The state negotiated a settlement requiring the merged hospitals to freeze their revenues this year; starting next year, they would have to roll back their revenues at a rate of $12 million annually until the health commissioner rules on the merger.

The merger of the two large HMOs this year has also raised concerns. Feldman of the University of Minnesota considers the merger a watershed. "We've never had a merger, ever, in the [national] HMO market between two equal partners of this size," he said. Feldman and an associate, Bryan Dowd, asked the Justice Department to investigate the merger, but it did not intervene; the state attorney general's office also decided not to pursue the matter—in part for lack of resources, Docherty said.

Still, Feldman predicted that the merger will be bad news for consumers. He concluded in a study that the HMOs' profits could rise by as much as $15 a month per enrollee.

But health industry officials contend that the market is as competitive as ever, if not more so. "Right now, it's dog-eat-dog," said George Halvorson, the former head of Group Health Inc, who is now president of its post-merger parent, Health Partners. "It's an extraordinarily competitive marketplace," concurred K. James Ehlen, chairman of Medica, another large local HMO, which is owned by United Healthcare Corp. And leaders of the business Health Care Action Group say there are bound to be new competitors entering the market. The new Health Span hospital chain has talked of forming its own integrated network, as have some other local hospital systems and clinics.

Would-be competitors, however, could have a tough time breaking in. "In this market, the barriers are very high," the Citizens League's Baumgarten said. The state demands large capital reserves so plans can weather high risks and large losses. New plans also face a catch-22, he said: Unless they have lots of patients, it's hard to attract doctors and hospitals at competitive prices. But without an extensive network of doctors and hospitals in place, it's tough to attract patients.

Entering the marketplace could get even tougher as the push for integrated systems continues. Doctors and hospitals may be pressured to sign exclusive agreements with health plans, making it harder for potential competitors to put new plans together.

Interestingly, many large employers who are otherwise free-market devotees argue that when it comes to health care, competition isn't that important and might be counterproductive. "Think of health care as kind of a public utility," Steve Wetzell, the Business Health Care Action Group's executive director, said. "There is such a huge capital investment required to build a network to take care

of a population and deal with the geographic access that it doesn't make sense to create all these tiny little competing plans. You end up with overcapitalization. too much technology in the marketplace. and that's where people who look at it from a pure economic standpoint don't understand the unique nature of health care."

Wetzell and his group say that their active collaboration with doctors—employer representatives even sit in with the 20 groups of doctors that are formulating medical practice guidelines for their plan—works better than arm's-length dealings with several competing plans. "If this plan works so that we're getting the highest-possible-quality care, delivered in the most efficient manner possible, with every dollar spent wisely, shouldn't this be the only plan we offer?" Hamacher asked.

Feldman's colleague Dowd, a health policy analyst, says that collaboration can't beat competition. "No one has said it's a bad idea to demand hard information on the outcomes of care from providers and to work hard to buy the right thing rather than the wrong thing," he said. "The point is that merging health plans will make it more difficult for you, on the margin, to buy what you want at the lowest possible price."

Consolidation among big purchasers of health care could pose a danger as well. "When buyers become large, they can engage in collusion," lawyer Bloch said. "When the size of a [purchasing pool] is so big, it can have market power that it can use against providers to drive down price below cost," forcing providers to "cut corners," he said.

Feldman also frets that consumers will suffer as big purchasers square off against big providers. "The market is pushed and pulled by bargaining power toward what the buyer wants or toward what the seller wants, but only by luck is it pushed toward getting the product consumers want, in the amount consumers want to buy, at lowest possible cost," he said.

WHAT ABOUT THE LITTLE GUYS?

The debate in the Twin Cities is being echoed in Washington as the Administration and Congress consider options for reforming the nation's health care system. Although the Administration has yet to unveil its plan, it's widely expected to encourage integrated health care systems as well as purchasing pools that increase buyers' clout.

In Minnesota, "I think you're seeing a forerunning of what could happen at the national level," lawyer Bloch said. "Big buyers putting together pools and demanding formation of approved health plans, exactly the same thing that's envisioned in national reform."

Insurers, hospitals and doctors around the country are already scrambling to figure out a way to survive in the new world order. In St. Louis, denominational differences were thrown out the window as Barnes-Jewish Hospital and Christian Health Services merged recently. In Washington, the American Hospital Association and the Blue Cross and Blue Shield Association recently held a how-to conference spotlighting collaborations between insurers and hospitals in local markets, an approach they called "community-based partnerships."

And the nation's five biggest health insurers one by one split off from the Health Insurance Association of America during the past two years, making clear that they felt their future lay in shedding their identity as traditional indemnity insurers and becoming instead managed care companies that would have a role in a reconfigured marketplace. The big five—Aetna Life and Casualty Co., Cigna Corp., MetLife, Prudential and Travelers Corp.—along with some of the stronger Blue Cross and Blue Shield plans, may be among the few insurers that have sufficient capital and know-how to build integrated plans and enter new markets.

The rush to consolidation and integration in the health care business has spurred the American Hospital Association and the American Medical Association to call on the federal and state governments to relax their antitrust laws. *(See NJ, 10/24/92, p. 2428.)*

But the urge to merge has also inspired concern at the national level. "Clearly there are some efficiencies from mergers that can eliminate duplication and waste," Bloch said. "But exactly where the magic line is between efficiency and market power used in an anticompetitive way has got to be a central concern of policy makers."

Magaziner said he wants to make sure that "in the transition stages, the five big insurance companies that have capital ... [do] not have an unfair advantage over local groups of doctors" who want to form health plans. "Health care is a local business," he said.

The Administration is considering measures to ensure that small, local players can continue to enter the marketplace, Magaziner said. For example, such plans might be offered a kind of insurance against bankruptcy if they attract more bad risks than expected in their early years. Another measure might be to offer low-interest loans to local groups trying to form plans.

Earlier this year, a working group of the White House task force recommended against relaxing antitrust laws as they apply to physician collaboration and hospital mergers—although it suggested that the government give clearer guidance to doctors and hospitals about what is permitted under current laws.

White House health reform task force head Ira C. Magaziner
"All businesses want to become an oligopoly if you let them."

But no final decision seems to have been made on the group's recommendation to repeal the insurance industry's antitrust protections under the McCarran-Ferguson Act. "We want to modify the antitrust laws somewhat but still pursue an antitrust framework ... to prevent anyone from getting a corner on the market," Magaziner said. "We'll probably leave it in the middle somewhere." ■

America's Most Trusted Profession Asks You to Support

H.R.9
S.84
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Independent retail pharmacists— health care professionals and small business entrepreneurs—are America's most accessible health care resources. Repeatedly in recent Gallup Polls the public has judged druggists/retail pharmacists to be the nation's most trusted professionals.

The National Association of Retail Druggists (NARD) is the association representing the professional and proprietary interests of the nation's independent retail pharmacists. Consumers obtain 70 percent of the nation's retail prescription drugs and related pharmacy services from independent retail pharmacists. The 40,000 independent retail pharmacies NARD represents, where over 75,000 pharmacists practice, are concerned about a wide variety of health and business issues. The insurance industry's price fixing, its access to unfairly priced drugs, and the consequential denial of consumer equal access to participate in insured prescription drug programs overshadow all other concerns. H.R. 9 will reestablish for these programs the hallmarks of our private prescription drug marketplace: consumer choice and fair competition.

The Insurance Competitive Pricing Act, introduced by Chairman Jack Brooks (D-Tx) and Senators Howard Metzenbaum (D-Oh), Edward Kennedy (D-Ma), Joseph Biden (D-De), and Paul Simon (D-Il), as H.R. 9 and S. 84, enjoys the support of a wide array of consumer, labor, business and law enforcement groups. H.R. 9 is the product of a long-term, thoughtful, steady, patient effort to substitute pro-consumer and pro-competitive market forces for price fixing, tying, monopolization and market allocation.

Small business strongly supports H.R. 9, including the Small Business Legislative Council (SBLC), the independent, permanent coalition of more than 100 trade and professional associations representing the interests of more than 4 million small businesses in manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture. The insurance industry stands virtually alone for price fixing and against increased competition.

Although the record fully supports repeal, H. R. 9 is not an outright repeal of the McCarran-Ferguson antitrust exemption. It is a compromise. It specifically immunizes from any antitrust challenge activities that are unique and essential to the insurance industry. The state regulation of insurance provisions of the Act remain intact.

Industry is attempting to miscast H.R. 9 as partisan. It is not—unless supporting small business and consumer interests in preventing price fixing and other anti-competitive insurance activity is the exclusive domain of Democrats. Industry opponents will ask you to defend insurance price fixing and their coercive, anti-competitive practices that deny your constituents equal access to small businesses, including pharmacies.

The answer is simple: these practices are indefensible.

In the 102nd Congress, the House Judiciary Committee approved H.R. 9.

Stop Price Fixing by the Insurance Cartel

Support
"The Insurance Competitive Pricing Act"

John M. Rector, General Counsel
Department of Government Affairs • Legislative Defense Fund
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ROLL CALL
THE NEWSPAPER OF CAPITOL HILL

July 19, 1993

Mr. BROOKS. I have a few questions, but I think I will ask just three or four questions to all of you generally.

Mr. Hunter, industry representatives claim that if joint trending projections lose their immunity, many insurance companies would be unable to recover. After H.R. 9 is enacted, would small insurers be able to obtain reliable trending services at a reasonable cost?

Mr. HUNTER. The answer is yes, sir. We have trials now in three States at least. The antitrust exemption has been repealed in California since proposition 103 passed in 1988.

There are more insurers now in California than there were at the time of passage. There has been no diminution of numbers of insurers. ISO has not produced any trended information since 1988. The profits of insurers have actually gone up, although the prices have stabilized.

California was the third highest cost State in terms of price increases year by year, between the years 1983 and 1988. And for the last 5 years, since the passage, California's prices are the third lowest instead of the third highest.

So prices have come down. Profits have gone up. Insurers have become more efficient in their activities because of the competition. ISO has not given trended data but has given other kinds of data.

Mr. BROOKS. ISO does not furnish trending data since 1988?

Mr. HUNTER. Since 1988 in California. And neither trend nor loss development in New Jersey for the last several years. Texas, as you know, has also applied antitrust law to its auto insurance markets and some other markets.

So we have had experience now. Small companies thrive. There are plenty of consulting actuaries around. ISO can actually make the trend data points available, because that is historic data. But the judgment, the speculation about what that data means for the future should be done by independent actuaries easily and cheaply, and as we see in California and other places. The benefits of competition greatly outweigh any small increase in price for consumers for individual companies having to get actuaries.

So the answer to your question is, there would be no problem getting trend data to small companies.

Mr. BROOKS. Mr. Fusco, do you want to add to that?

Mr. FUSCO. I would rather not add to that, but disagree with that. There would be a problem for small companies to calculate trends on their behalf. There are not enough casualty actuaries to go around, so that we could have one for every company.

Mr. Hunter referred to California as a State in which ISO has not submitted trended or prospective loss costs. We have submitted trend data, as Mr. Hunter knows, in California, and companies have gotten by.

California is a situation in which a lot of litigation is going on. I would not characterize it as a healthy insurance market. Something that is working in one particular State, to hypothesize that that would work well in all 50 States as a rule, I think, is a great leap.

I would also like to characterize what ISO does is independently-arrived-at trend data. Our staff are trying to give to our companies the best answer that we can determine as to the prospective loss

costs. For that to be replicated by 1,500 individual companies would be done at great expense.

Even today, those companies have the opportunity to disagree with ISO's calculations and judgments by hiring independent actuaries on their own, as their own employees, as consulting actuaries. That process would be much cheaper, to examine what ISO has done and the detail with which they have given that information to companies, and make the necessary adjustments and correct for an individual company. But to start from scratch and do that work themselves would have to be done at much cost and effort.

Mr. BROOKS. Would you explain to us what information is used in the trending process, other than information obtained from the statistical base of historical loss data, that needs to be gathered collectively on an industrywide basis in order to be reliable?

Mr. FUSCO. I would like to read to you some of my testimony, if I may, since I think it draws upon it. It also disagrees perhaps——

Mr. BROOKS. It is covered in that testimony?

Mr. FUSCO. Not fully. I will add to the bit of the testimony as well.

Mr. BROOKS. Why don't we just take the testimony and add to it what you want to add to it.

Mr. FUSCO. I would like to disagree at the beginning with the statement that Anne Bingaman made this morning, and that Bob Hunter seemed to agree with, that trend is easy. Trend is not easy. Trend is a particularly complicated actuarial calculation.

And our actuaries use internal data, meaning actual insurance data, over many periods of years to calculate what trend might be. We also look at judicial changes, legislative changes, and other external econometric models for the purpose of calculating trend. I would have to say it is not an easy process.

What we are trying to get to is what is the prospective loss cost, which is cost information, we are trying to send to companies, not price information. How much is it going to cost to cover loss for the future for a particular set of policies.

I don't want to be redundant. Much of that is in this testimony.

Mr. BROOKS. Mr. Hunter, you are an actuary. What do you think of that?

Mr. HUNTER. We have the essence of the argument going on here. What happens with trending is, we are taking a lot of elements like judicial decisions, as has been just mentioned, legislative changes, those kinds of things, and saying to ourselves, what will that mean in the future, next year, what is inflation going to be next year.

And what ISO does is take all that and put it into one number and say, industry, this is what it is next year. And everybody goes with it. And because they want to make it high enough for their least efficient company, they always pick the highest trend factors.

I can tell you from reviewing them year after year, State after State, ISO trend factors are high, they cobble one shoe for the whole industry, and it is a size 25, because otherwise some of the ones with big feet would get their feet pinched. As a result, everybody pays too much for insurance. That is the essence of trending.

It is not joint trend data we disagree with. Joint trend data should be promulgated, as they do in California. But to take it, put

lives through it, and say what next year the costs are going to be is the essence of price fixing, and that is what they do.

Mr. BROOKS. Mr. Fusco, the insurance industry has claimed their reason for opposing H.R. 9 is to preserve State authority to regulate effectively. If that is the case, why has ISO been lobbying so furiously to take away the Texas insurance board's longstanding authority to determine the kinds of data that need to be collected for effective insurance regulation?

Mr. FUSCO. I don't think that is a true statement.

Mr. BROOKS. You don't think ISO is lobbying against the Texas insurance board, working against it? Is ISO for it?

Mr. FUSCO. ISO has been a licensed statistical agent in the State of Texas and would like to maintain our status as such. What the Texas department has done now is put out an RFP, a request for proposal for certain organizations to apply to become the State data collector for Texas. My reading of that particular legislation is that we are precluded from applying for that because of our ties to the insurance industry. And we did lobby to try to not have that happen.

Mr. BROOKS. You lost.

Mr. FUSCO. That is the current state.

Mr. BROOKS. Mr. Nelson, would the application of the antitrust laws to the insurance business make it harder for agents like you to offer the consumer the best insurance product at the lowest available price and meet their requirements?

Mr. NELSON. Without the application of the antitrust protection, independent insurance agents like myself cannot today safely comparison shop and offer consumers the lower cost products in the marketplace. They are available in the marketplace, they are filed at the State insurance departments, but without the protection of antitrust, you risk the loss of your business if you actively go out and offer those lower cost price policies to all consumers.

Mr. BROOKS. Mr. Pollard, what are some specific examples of insurance innovation that you believe would be stifled by a limited application of the antitrust laws to your industry in those States where they might possibly apply?

Mr. POLLARD. Well, I think some specific examples would be new products in which we depend on the analyzed data to set the benchmark, and then we can have our own people go in and come up with an innovative product we might file.

Based on the use of the information, that data that has been analyzed by several people, and that is the crux of this argument we are talking about here, is that the trended data has been based on several opinions, not just by actuaries but by economists, and companies can rely on that benchmark data. Individual companies can then make their own decisions. If we don't have that data, our ability to innovate will be much more conservative in that regard.

Mr. BROOKS. Ms. Lipsen, some opponents of the legislation claim that the interested parties are primarily a few consumer activists in Washington. From your experience, can you tell us whether consumers around the country have an opinion, have some feeling about the insurance industry being exempt from antitrust laws?

Ms. LIPSEN. It depends how you ask the question. If the question is posed to the Nation's consumers: What do you think of horizontal

arrangements—they don't know. If you ask them what they think about the insurers price fixing, the answer is they don't like it and they want to see repeal or modification of the unjustified McCarran-Ferguson Act.

We have worked with a group of consumer organizations which represent seniors, women, and the disabled. For many years this coalition has tried to do something about this unjustified, outmoded act. We have also worked with labor and small business and banks and many others, and we disagree on almost everything except we agree on this bill. We call for its prompt passage now.

Mr. BROOKS. Thank you.

Mr. Rector, as a board member of a major small business association, how widely is your concern over this issue shared among Americans in small business?

Mr. RECTOR. I would say virtually across the board, down Main Street, America. The small business legislative council SBLC that I am here representing today would echo the chairman's concerns about the need to move expeditiously with H.R. 9.

We may have some size 25 shoes in that crowd, but earlier comments were made about being to the left. I would hate to see our small business groups tainted as if they are leftists or something. Most of them figuratively couldn't spell left. They are mainstream, mostly Republican, and they are strongly in support of H.R. 9.

Mr. BROOKS. I hope they can write.

Mr. RECTOR. They can write very well.

Mr. BROOKS. I want to thank all of you very much.

Mr. CONYERS. Mr. Chairman, might I intervene?

Mr. BROOKS. The chairman of the Government Operations and ranking member of the Judiciary Committee, a wonderful member, with a wonderful little son who had his picture made with President Clinton.

Mr. CONYERS. At least once yesterday.

Mr. BROOKS. Two or three times.

Mr. CONYERS. Probably more.

Thank you, Mr. Chairman.

I would like to thank everyone on this panel, including the insurance representatives, who are very fine people. Mr. Fusco, Mr. Pollard are gentlemen who are probably in their own way great Americans, and they represent a very important industry that we have to take into consideration and remember how important this industry is and how important this subject matter is.

I think you would both agree with me there. The problem is that the abuses, gentlemen, have been piling up to such an extent that even people in your industry are now urging us to make reasonable adjustments to the exemption that has netted you trillions of dollars over the decades.

And so as a reasonable and modest subject member of the Judiciary Committee, I am following my leader, the chairman of this committee. This may be a dangerous undertaking, because the insurance industry does not take lightly to these changes that have been proposed. And I for one will hope that my relationship with the fine leaders of this industry will not be disturbed in any way by the courageous step I find myself taking with the encouragement of Chairman Brooks.

Could you give me that assurance on the record? Silence. Let me try it another way.

Have you looked with favor upon my performance as a national legislator, and that whatever that favor is, it will not be altered by the legislative battles that may come out of these hearings? I understand there are about nine more scheduled.

Mr. Pollard can shake his head in the affirmative. Mr. Fusco, could you do the same?

Mr. FUSCO. Absolutely.

Mr. CONYERS. And you can say "absolutely."

Mr. POLLARD. We respect your kind remarks about us, too. Thank you.

Mr. CONYERS. You are more than welcome, sir, but you haven't made any kind remarks about me. Could you reciprocate in some small fashion?

Mr. POLLARD. I shook my head and said yes.

Mr. CONYERS. That is about all you can do. Well, I think I get the idea, Mr. Chairman.

Thank you Mr. Chairman.

Mr. BROOKS. The gentleman from North Carolina.

Mr. WATT. Mr. Chairman, I wanted to say kind things about Mr. Conyers. He seems to be in need of somebody to say something kind about him. He is a very kind man. And as with Mr. Pollard, who happens to be from North Carolina.

I wanted to express my apologies to this panel for not being able to be here. I have been in a markup of another bill in another committee. I hope to review your testimony along with the testimony of other people who have been on earlier panels this morning. I apologize for not being here.

Mr. BROOKS. Thank you all very much.

I think it is clear from today's hearing that we have reached a significant turning point in the drive for legislation to modify McCarran-Ferguson. The support for the effort is continually growing.

It is time for those who oppose any reform effort, however reasonable, to think very hard about whether their opposition is about maintaining a revered symbol of special treatment or whether it is about making the industry more competitive and robust.

In the 1990's, none of us has the luxury of opting for symbols at a time when competitiveness is the key ingredient to jobs and growth and a better economy for all Americans. The time has come to act, and that we intend to do in very short order.

Thank you very much.

The subcommittee is adjourned.

[Whereupon, at 12:50 p.m., the subcommittee was adjourned.]

APPENDIXES

Appendix 1.—Responses to Additional Questions for the Record

Republican Members Questions For The Record

Questions for:

Anne K. Bingaman, Assistant Attorney General, Antitrust Division, U.S. Department of Justice

(1) What specifically is the position of the Department of Justice on the language contained in the "Insurance Competitive Pricing Act of 1993" (H.R. 9)? Do you support the legislation in its current form? What amendments would you suggest?

Answer:

As I said in my statement, the Department believes that the time has come to act on McCarran-Ferguson legislation, and supports the efforts of the Subcommittee to replace the current broad exemption for the business of insurance with more carefully crafted protection for activities that are demonstrably potentially procompetitive and efficiency-enhancing. We are continuing to consider carefully the specifics of such legislation. Thus, I do not have any comments on the language of the present bill or any recommendations for amending the bill at this time.

(2) Mrs. Bingaman, your prepared testimony (on page 4) reads: "[T]here are strong indications that possible justifications for the broad insurance antitrust exemption in the McCarran-Ferguson Act when it was enacted in 1945 are no longer valid today." Upon what facts is this conclusion based? What are the "strong" indications"? Don't many insurers still need the jointly collected and shared data?

Answer:

Over time, the antitrust laws have developed in several significant ways that make the need for an antitrust exemption far less compelling today than it was in 1945. One important development has been the clarification of the state action doctrine. In 1945, when the McCarran-Ferguson Act was enacted, the state action defense, which had been announced by the Supreme Court in Parker v. Brown in 1943, was quite unclear. This defense, which allows a state effectively to immunize what the antitrust laws otherwise

may proscribe by clearly articulating and affirmatively expressing a policy to displace competition and by actively supervising any private conduct that might be involved, has now been the subject of many Supreme Court opinions, which have greatly clarified the application of the doctrine to state regulated activities. Perhaps even more important is the increased sophistication of the antitrust laws themselves in the last 50 years. Some forms of joint activity that might have been prohibited under earlier, more restrictive doctrines are now clearly permissible, or at the very least analyzed under a rule of reason that takes appropriate account of the circumstances and efficient operation of a particular industry. The improved analysis of joint ventures has been one of the most salient developments in antitrust law in recent years, and along with the clearer delineation of the state action doctrine, has enormous significance for the operation of the insurance industry in a post-McCarran environment. As you note in your question -- and I agree with you -- many insurers do still need some types of jointly collected and shared data. Particularly with the improved antitrust analysis of today, I don't see the antitrust laws as a threat to necessary, procompetitive joint data collection and sharing activities.

(3) On page 7 you refer to the "safe harbor" approach. Are there particular "safe harbors" that you believe should be contained in this legislation? Could you specify what they are and how they should be worded?

Answer:

At this time, I have not reached any conclusions on the specific safe harbors. Many activities that have been mentioned as possible safe harbors would not ordinarily violate the antitrust laws, as the antitrust laws only condemn unreasonable restraints of trade, and activities that are on balance procompetitive would not be prohibited if the broader exemption were repealed. While it seems to me that the burden of showing the need for a safe harbor rests with those who are seeking it, we are continuing carefully to consider proposals for safe harbors.

(4) Is it possible that the state action defense might not be available in many states because of the type of insurance regulatory scheme they have adopted? Wouldn't a differing

result on state action applicability from state to state create serious confusion and antitrust enforcement problems?

Answer:

The recent Supreme Court decision in FTC v. Ticor Title Ins. Co., __ U.S. __, 112 S. Ct. 2169 (1992) sheds much light on the question that you are asking. Under Ticor, the state action defense allows a state effectively to immunize what the antitrust laws otherwise may proscribe by clearly articulating and affirmatively expressing a policy to displace competition and by actively supervising any private conduct that might be involved. It is certainly possible that some states will not wish to provide this defense to insurers and will opt instead for the application of the antitrust laws as the best means of providing to their citizens full and adequate insurance coverage at a fair and reasonable cost. But, in answer to the second part of the question, I don't see any reason why this should ncessarily lead to serious confusion and antitrust enforcement problems. State action issues arise in many other contexts. They are a normal part of antitrust practice and jurisprudence and I don't see any particular problem in dealing with these issues in the insurance area.

ISO'S RESPONSE TO MR. BROOKS' QUESTION FOR THE RECORD FOR MR. FUSCO

> On page 9 of your statement, you say, "Economists cite the availability of complete information as one characteristic of a fully competitive market." I think you may have been trying to suggest that the existence of your rating bureau activities is evidence that the insurance industry is competitive. But the economists you refer to are talking about information freely available in the marketplace, not only for certain sellers, but most importantly for the buying public. That is the key. Would you tell us if the information you collect is freely available to the public? And, if not, do you advocate making it so?

ISO's prospective loss costs are available to both sellers and the public.

Availability to Sellers:

Participation in ISO is available to any property/casualty insurer authorized to write an ISO line or subline of business in a U.S. jurisdiction.

Availability to the Public:

ISO's products and services are also available to the public. ISO currently makes directly available to the public a number of its products and services that may be of general interest or that are capable of being used without further modification by insurers or brokers. These include such things as sample forms, insurance manuals, statistical plans and monographs on issues of general insurance interest. If a consumer is a customer of an insurer who uses our prospective loss costs, on request, we will provide full information about those prospective loss costs directly to that consumer. In addition, ISO's prospective loss costs, along with detailed supporting information and the compiled reports of the data it collects from insurers, are available to the public at insurance departments throughout the United States. The prospective loss costs and detailed supporting information that ISO submits to state regulators are the same information that is distributed to insurers.

It is worth noting that we get only sporadic requests directly from the public. This is not surprising given the highly technical nature of our products which are designed for use by insurers, agents and brokers, and not for the general public. ISO prospective loss costs are likely to be particularly confusing to consumers since they are not prices, but rather average estimates of future costs. Consumers do have access to price information through agents, brokers or insurance department consumer guides.

ISO'S RESPONSES TO REPUBLICAN MEMBERS' QUESTIONS FOR THE RECORD

(1) What has been the impact of the 1989-90 ISO changes on the state insurance regulators? Have the states responded by hiring more personnel and increasing the budgets for the various commissions and insurance departments?

ISO has not conducted any formal study of the impact of the transition to prospective loss costs on state insurance departments. However, based on discussions and general information, it is our understanding that the transition to prospective loss costs has had a manageable impact on state insurance departments in terms of both budget and staff. Insurance departments in general have not had to dramatically increase staff to handle the additional workload. There are several factors which contributed to this.

Our gradual, carefully planned, phased-in approach for implementing prospective loss costs was deliberately designed to minimize disruption to insurers, regulators and consumers. ISO worked closely with individual insurance departments to develop a line-by-line transition schedule that provided for an orderly and smooth transition without overwhelming regulatory staffs or insurers with filings.

Also, the National Association of Insurance Commissioners (NAIC) developed model laws, bulletins and regulations for states to use in introducing a prospective loss cost filing system. The NAIC's goal was to introduce a set of procedures that were user-friendly and that would standardize the filings from insurers. These procedures, which were generally adopted by each of the state insurance departments, with modifications made where necessitated by individual state law, provide for a standardized method of filing construction, which tends to expedite the review process.

In addition, the NAIC made available educational training to insurance departments to assist staff in handling and understanding the move to prospective loss costs and its impact.

Finally, in recognizing that the transition to advisory prospective loss costs represented a profound change in the way insurance rates are made, ISO embarked on an education drive to ensure that insurers understood the implications of the transition, as well as the procedures under which they would have to operate. In general, insurance department staff advise us that insurer filings are generally complete and correct, and that this has allowed them to process such filings in an orderly manner.

(2) What are the purposes of the statistical plans designed by ISO and filed with the various state regulators?

The purposes of ISO's statistical plans are to:

(a) fulfill ISO's role as a designated statistical agent for state regulators, functioning to assist regulators in complying with statutory requirements relating to the regulation of rates;

(b) permit ISO to collect the information it needs to perform detailed data quality reviews and to develop prospective loss costs and various classification differentials; and

(c) to provide insurers with industry information for use in their own decision-making.

(a) Assisting the Regulator:

State rating laws charge the state regulator with ensuring that rates are not "excessive, inadequate or unfairly discriminatory" and require that insurers report data to the state regulator so that the regulator has enough information to determine if rates and rating classifications are in compliance with those statutory standards. Most state rating laws permit the state regulator to designate a statistical agent to assist in the collection of data. The NAIC has developed a Statistical Handbook of Data Available to Insurance Regulators that sets forth minimum standards by line of insurance for the data that must be collected and reported by all property/casualty statistical agents. The statistical plans that ISO designs to collect detailed loss cost information meet, and in most cases exceed, the minimum requirements established by the NAIC for statistical reports and statistical agents.

(b) Development of Prospective Loss Costs and Classification Relativities and Data Quality Reviews:

ISO uses the data reported to it to develop advisory prospective loss costs and various classification differentials and other actuarial analyses. These analyses form the basis of the advisory prospective loss costs that ISO files with state regulators and distributes to insurers.

Some of the additional information collected under the ISO statistical plans allows ISO to perform detailed quality reviews of the data.

(c) Data for Insurers:

In addition to providing the filed advisory prospective loss costs, ISO makes available industry compilations of various data for use by insurers in their independent decision-making.

(3) Is there a shortage of qualified actuaries nationwide? If so, what can be done about this shortage?

If one accepts the definition of a "qualified property/casualty actuary" as a person who has passed a series of examinations and has sufficient experience to be designated as either an Associate (seven examinations) or a Fellow (ten examinations) of the Casualty Actuarial Society (CAS), then the numbers speak for themselves.

According to the 1993 Casualty Actuarial Society Yearbook, there are 816 Associates and 1,121 Fellows. Currently, of the total of 1,937 Associates and Fellows approximately 1,100 are employed by the larger insurers and reinsurers, 437 are employed by consultants and the other 400 are either employed by organizations, like ISO, large agents and brokerage houses, government agencies, or are retired.

Due to the rigorous study and training necessary to become qualified, the supply of actuaries cannot expand quickly to meet the demand for qualified actuaries. It takes an average of about five to six years to become an Associate and about ten years to become a Fellow of the CAS.

(4) As you know, critics charge that trending information is subjective, potentially discriminatory, and can result in certain classes of insureds paying excessive costs for liability coverage. How do you respond to these criticisms?

Some people think trending is a simple procedure and easy to apply. It's not. It is not merely a measure of general inflation nor is it the routine application of a mathematical formula. The trend process is complex because it requires a careful examination of factors likely to influence claim severity changes over time, claim frequency patterns over time, and changes in exposure growth patterns. These analyses require the evaluation of deductibles, policy limits, non-recurring events and the propensity to litigate and the effect of these factors on insurance loss costs. The analyses require among other things:

- selection of appropriate data bases both internal to insurance and external as well;
- reviewing data over both the short-term and the long term;
- reviewing data countrywide and state-by-state and knowing when it is appropriate to use which data base;
- reviewing data line-by-line and coverage-by-coverage and understanding when, if and how that data may have been influenced by external events; (For example, for auto insurance, this includes consideration of things such as changes in speed limits, road conditions, traffic density, gasoline prices, the extent of driver education and drunk-driving patterns); and
- many other factors which might affect the loss experience for a particular coverage, line of insurance or state.

Objective, non-biased trend analyses are best performed by knowledgeable professional actuaries who have expertise in developing the data base as well as a thorough understanding of the data they are reviewing. Professional judgment is required throughout the process, but objectivity is best assured by having the trend analyses performed by those actuaries whose sole purpose is to provide accurate cost information to insurers, regulators and others. At the same time, insurers receive all the data used in ISO's trend analyses so they can make their own informed judgments.

There is no incentive for advisory organizations, like ISO, to provide biased analyses which over-estimate future costs. This would place insurers that rely on these analyses at a competitive disadvantage. Any insurer that relies on inflated cost estimates would find itself priced out of the market, would lose marketshare, and would soon lose interest in purchasing such biased information.

(5) Were smaller insurers placed at a greater disadvantage because of the ISO decision in 1989 to no longer provide advisory rates?

The transition to advisory prospective loss costs has added additional costs to the system, and there have been some opportunity costs as insurers geared up and refocused their staffs and operations to operate under the new system. While ISO has not conducted any formal survey, it is our understanding that some insurers are hiring new personnel, establishing new or expanded pricing units, and investing in new computer hardware and software -- all at additional cost. While the exact opportunity costs cannot be measured, insurers have had to dedicate staff solely to the issue of prospective loss cost filings and this has kept them from concentrating on other issues.

These costs may have a proportionately greater impact on smaller insurers that, as opposed to larger insurers, do not have the staff or in-house expertise needed to absorb these new responsibilities. However, to date, these costs appear to be manageable. We believe this is attributable, in great part, to the hard work and planning that was put into the process by state insurance regulators, ISO, insurers and other industry interests, as highlighted in our response to question number one.

(6) Are there any major property/casualty companies that are not members of ISO?

Yes. There are major property/casualty insurers that are not members of ISO. In fact, for those lines of insurance that most affect consumers, auto and homeowners, ISO participating insurers have a relatively limited market share. For example, A.M. Best figures indicate that, on a countrywide basis, the top ten writers of private passenger automobile insurance write about 55% of the total premium volume. Only four of the top ten insurers are ISO participating insurers and they write approximately 11% of the countrywide private passenger automobile premium volume. The leading writer of personal auto insurance is a non-ISO company and has a larger marketshare than the top four ISO companies combined.

A state-by-state analysis shows the same pattern. For example, in Kansas, the top ten writers of private passenger auto insurance represent 76% of the total statewide premium volume. Only two of these are ISO participating insurers and they write 3.7% of the total statewide premium volume. In Florida, the top ten companies write 71% of the personal auto market and the two ISO companies in the top ten write 3.6%.

The number of ISO participating insurers varies significantly by product, by line of insurance and by state. As I said in my original testimony, unlike rate bureaus of the past, all of ISO's products and services are advisory, including prospective loss costs and standardized coverage parts. Insurers have no obligation to ISO, or any other entity, to buy those products or services or to use them.

The personal lines of insurance, such as personal automobile and homeowners insurance, are characterized by high market concentrations and a greater volume of reported losses. For the personal lines, the top insurers have data that may be sufficiently credible to calculate their own prospective loss costs. Since the high volume of losses translates into high premium volume, ISO's economies of scale may be less significant to them. Nevertheless, the need for ISO's information and services is essential because many small and medium-sized insurers do not have the data and resources that the larger insurers have available.

(7) Are there any other organizations that provide the same or similar services as ISO?

There are a number of organizations that provide insurers with services that are the same or similar to those provided by ISO. Some of these organizations provide only some of the services that ISO provides. Some provide services only in a single state or only in a limited geographic area, while others limit their services to a particular line(s) of insurance. For example, the American Association of Insurance Services (AAIS), the National Association of Independent Insurers (NAII) and the National Independent Statistical Service (NISS) are statistical agents. AAIS also serves as an advisory organization for some personal and commercial lines of insurance. The National Council on Compensation Insurance (NCCI) develops and administers rating plans and rating systems for workers' compensation insurance. The Surety Association of America (SAA) is a statistical agent and advisory organization for fidelity and surety insurers.

Some states also have their own designated statutory rating bureaus to which every insurer must belong. One example of this type of statutory bureau is the Massachusetts Automobile Rating and Accident Prevention Bureau, which determines private passenger and commercial automobile insurance rates for the State of Massachusetts.

With respect to development of loss cost trending analyses, other ISO "competitors" are independent consulting actuaries and individual company actuarial staff. However, even these entities benefit from ISO's aggregate data base, as well as ISO's extensive and detailed loss development and trend analyses. They use the information as a tool in assisting them to determine the adequacy of their own individual information in relation to the industry as a whole.

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It is obviously more efficient to allow either ISO or independent consulting actuaries to work within their own area of expertise. ISO has one of the largest actuarial staffs in the property/casualty industry -- with in-depth knowledge of the data and the multiple, complex technical considerations involved in trend analyses. Consequently, ISO has the expertise to cost-effectively analyze appropriately pooled information and perform the thousands of trend analyses needed to produce average prospective loss costs.

On the other hand, independent actuaries have expertise in the analysis of individual insurance company operations rather than aggregate, industrywide data. If the trend indications developed by ISO were not available, insurers and others would be deprived of the benefit of having high quality and reliable industrywide trend factors and analyses. In addition, multiple compilations and actuarial analyses of aggregate industrywide insurance data, in addition to individual company data, would be inefficient and costly for insurer clients of independent actuaries. The property/casualty industry today thus maximizes its actuarial resources through advisory organizations, such as ISO.

REPUBLICAN MEMBERS QUESTIONS FOR THE RECORD

Questions for:

Eric G. Gustafson, President, Independent Insurance Agents of America

(1) Some have argued that the language of H.R. 9 might prohibit insurers from making territorial assignments for agents and also could require or force agents to write policies on risks which they would not otherwise write. Would you care to comment on this as a possible problem in H.R. 9?

H.R. 9 effectively makes it unlawful for an insurance company to "allocat[e] with a competitor a geographical area in which, or persons to whom, insurance will be offered for sale." Horizontal agreements restricting competition among companies at the same level of the market structure, even when involving non-price facets such as territorial carve-ups, have generally been treated as per se illegal under federal antitrust laws. Thus, to the extent that companies make territorial assignments on this basis -- dividing up the market geographically among each other -- H.R. 9 would no longer permit them to do so.

It is our understanding that, most often, companies are not allocating territorial assignments in conjunction with competitors, but rather each company unilaterally makes territorial assignments among its own agents. It is unclear whether such unilateral action is subject to federal antitrust laws under H.R. 9. If it is, it would be unlawful under the Sherman Act if the company has sufficient market power and the practice disadvantages consumers -- i.e., if intrabrand competition is diminished. Such vertical non-price restraints are examined under the rule of reason test. The problem with assessing the risk of any given company's practice being found illegal is that little or no case law has developed regarding the definition of relevant markets, barriers to entry in the industry, and similar critical antitrust factors. The outcome would also necessarily vary depending on the particular geographic area and insurance product at issue. For example, in some geographic markets, one company has significant market power in automobile insurance.

We note, in addition, that companies' collective decision to pull out of a particular geographic market (for example, to discontinue writing property & casualty insurance in Florida coastal regions) could constitute a boycott under antitrust laws. Of course, boycotts are unlawful as applied to the insurance industry under the

current version of the McCarran Ferguson Act, and nothing in H.R. 9 would alter that principle.

(2) What about the language in H.R. 9 raises questions about the legality of tying or packaging two or more insurance products together? Do the independent agents have a view on that particular language?

H.R. 9 would make federal antitrust laws applicable to the "unlawful tying [of] the sale or purchase of one type of insurance to the sale or purchase of another type of insurance." One simple example of tying in the personal lines insurance market is some companies' practice of conditioning the sale of umbrella liability insurance on the sale of homeowners and/or automobile insurance.

As outlined by the Supreme Court in its leading tying cases, tying is unlawful under the antitrust laws only if the party imposing the tie has sufficient "economic power" in the tying product (umbrella liability insurance, in the example above) to "appreciably restrain free competition in the tied market (homeowners or automobile insurance, in the example above), and a "not insubstantial" amount of commerce in the tied item is affected by the arrangement.

The two purportedly tied items must entail separate products or services -- an inquiry which has proven to be complex in other contexts. The language of H.R. 9 appears to be written to avoid some controversy in this regard by using the phrase "type of insurance" in reference to the products involved. The problem, of course, is exactly what is meant by "type of insurance." For example, is all insurance sold to businesses one type of insurance -- "commercial insurance" -- or can it be broken down into various different types of insurance -- e.g., auto, fire, etc. If the latter, the potential of finding tying is greatly increased. In our view, this point will have to be clarified to avoid uncertainty and inevitable wasteful litigation.

Clarity is of particular concern to agents because to the extent a company established some type of unlawful restraint, such as a tying arrangement, agents' exposure to liability could increase since imposition of the restraint would be done more directly by the agent to the consumer. This exposure will necessarily drive up independent agents' operating costs.

(3) Why does IIAA believe that the enactment of H.R. 9 would harm small, regional insurance companies as well as the so-called "niche" companies?

The role of the independent agent is to bring the value of choice to the consumer--to offer the consumer the easy ability to shop among insurance companies, and to compare and analyze competing products. In recent years, particularly, small, regional, and "niche" insurers have played a critical role in ensuring the availability and affordability of insurance. Thus, from the agents perspective, no change should be made in current law that would create artificial pressures on these companies, because it would lead to fewer markets or less meaningful customer choice.

As more fully explained in our oral testimony, the IIAA is particularly concerned that H.R. 9's limitations on shared trending will harm the competitive position of these companies. It is our understanding from our contacts in the industry that a prohibition on trending will disproportionately disadvantage small companies who cannot, in a cost efficient manner, develop adequate trending data on their own. By engaging in shared trending, smaller companies can substantially reduce the cost of the process to them individually.

Even if such a company could afford to assume the costs of the process entirely itself, chances are it simply would not have sufficient information -- a large enough data base -- to perform meaningful trend analysis. Those who have engaged in this practice successfully for years confirm that insurers need a large, aggregate data base of information about past losses in order to estimate future losses. Small and niche companies do not have this breadth of data. The same problem exists for any company wishing to enter new markets. For this reason, the "phase in" for small companies contemplated by H.R. 9 is of no comfort.

(4) Could you discuss the state anti-rebate laws and describe how they operate?

Beginning in the late 1800s, States enacted laws that prohibit insurance companies, agents, brokers, and others from giving rebates of premiums or agents' commissions as an inducement to insurance. Most States have such laws, and most of the statutes also prohibit discrimination among insureds of the same class and prohibit the giving of other consideration as an inducement to insurance. The statutes may either condemn specific practices or may in general terms prohibit rebates and discrimination. Unlawful rebates

take many forms, and are the subject of extensive and well-developed caselaw. At the most basic level, however, such laws generally prohibit an agent from remitting a portion of the agent's commissions to the insured or to an unlicensed third-party who assists in procuring the insurance business.

The purpose of anti-rebating and anti-discrimination statutes is to protect the solvency of the insurance companies, prevent unfair discrimination among insureds, protect the quality of service, avoid concentration of the market in a few insurance companies and/or agents, and avoid unethical sales practices.

Without anti-rebate statutes, agents would be left to determine how to act in a non-discriminatory fashion. And for agents whose income depends on commissions alone, elimination of such statutes could only serve to drive agents out of business and ultimately result in less competition. Consumers can be certain of the services they will receive if agents are compensated in a reasonable manner.

(5) Consumer groups have argued that agents are often not very well informed about the insurance products they sell and are in a conflict of interest with their customers because of the commission system. How do you respond to that criticism? Aren't the companies that sell without an agent the most successful? Do consumers pay more if an agent is involved?

All 50 States and the District of Columbia require insurance agents (except title insurance agents) to be licensed. Such agents must meet licensing requirements and in 43 States fulfill continuing education requirements. A growing number of agents are seeking professional designations -- CPCU, AAI, CIC, ACSR, and others -- that require extensive study and passing nationally conducted examinations. Moreover, at the most basic level, agents must know the products they sell and be able to explain them to their customers, or be prepared to face professional liability losses.

Personal lines research conducted by Parker Research directly refutes the claims of consumer groups that independent agents do not understand the products they sell. This study found that there are four types of buyers of personal lines. The category of buyer who was most interested in the details of the product and the competence and knowledge of the insurance agent was also the category <u>most likely</u> to use an independent agent.

The conflict of interest argument is similarly invalid. If the agent is not adequately serving the consumer, putting the customer's needs, interests and expectations first, the customer will switch to another service provider. Agents know the best way to maintain agency value is through high customer satisfaction and retention. It costs less to keep a customer than to acquire a new one; in fact, it is often said that it take years to recover the costs of acquiring a customer.

The most successful companies are not necessarily those companies without agents. There are some very successful companies that do not use agents, but the overall market share of agency companies -- that is, those using independent agents and exclusive agents -- remains approximately 90% of the personal lines market, and that percentage is holding steady. According to GEICO, a very successful direct response company and the source of this statistic, only a limited number of customers want to buy direct without an agent to consult on coverage needs. Indeed, GEICO has recently purchased Southern Heritage, a company using independent agents, in order to grow.

The small commercial lines customer focus groups conducted by Parker Research and another series conducted by Maryland Casualty revealed that these consumers wanted to deal with an agent, not a company. They wanted someone who was local and could serve as consultant for their insurance needs. They wanted the agent to explain coverage, get them the best coverage for the price, keep up with their changing needs, and be there (locally) when they needed them.

See also answer to Question (7).

(6) What does IIAA do to educate or train their members? What qualifications does someone have to have to be an agent? Any specialized training? Does every state license agents? Is there always a test?

IIAA has an affiliated state association in each State, and through these state associations conducts 4,900 classroom days of education for agents and their employees each year. Approximately 97,000 agency individuals attend these classes each year. An agent must meet the licensing requirements of each State in which the agent operates, and to be a resident agent must pass a test. Many States, in addition, require the completion of a specified number of hours of insurance education before sitting for the license exam. Forty-three States have continuing education requirements once the agent is licensed, and these laws typically require

15 to 18 hours of insurance education each year. As discussed in response to Question (5), more and more agents are securing additional designations in an effort to further increase their professionalism. IIAA supports continuing education laws and is dedicated to heightening the professionalism of insurance agents.

(7) One of the traditional criticisms of the agent system by consumer groups and others, is that it adds to the costs of insurance -- i.e., the purchaser has to pay your commission. How do you respond?

In some cases, consumers pay additional costs if an agent is involved; in other cases, they do not. For most functions, if the agent does not perform the task, the company will have to do so, obviously with some cost involved. In many cases, the agent, as a small business, can perform the function more inexpensively.

Fifty-two percent of the personal lines insurance customers surveyed in research conducted by Parker Research were "relationship buyers." Such buyers are far more interested in forming a long-term relationship with an agent than in just finding the lowest price. These buyers want someone who will give them advice, find the best coverage, review their needs at renewal time, and watch for new products. If non-agency companies provided the same services necessary to attract and keep the relationship buyers, they would have to incur additional costs to do so. Therefore, it is not a fair comparison to say consumers pay more if an agent is involved. Agents are providing additional services that companies alone are not providing. To the extent there are added costs involved, customers are getting value for their dollars.

(8) Not too many years ago, the insurance industry (responding to consumer complaints) jointly developed "easy to read" policy forms. How would efforts like that be affected if H.R. 9 is enacted?

Standardization of forms enables agents, consumers, and regulators to make meaningful price and coverage comparisons between insurers. The jointly developed "easy to read" policy forms are only one example of such positive, pro-consumer steps taken by the industry. However, standardization becomes suspect under antitrust law, and specifically under H.R. 9, as facilitating price-fixing and/or restraints of trade. It can certainly be argued that standardization of options is permissible under the federal antitrust laws, but standardization that reduces options is probably not

permissible. The problem is where the line between the two is drawn; that will have to be worked out through years of litigation. Insurance companies are not likely to want to risk antitrust lawsuits. Agents are thus concerned that, without a safe harbour for forms development, there will be little or no standardization. The consumer as well as the independent agent will be the loser.

(9) Under H.R. 9, large insurers would only be able to share trending information for two years after the effective date of the Act -- then small insurers could share trending information with each other for an additional two years. But what useful trending information could smaller insurers develop on their own? Don't the small companies represent less than ten percent of the overall data base? Isn't this provision really a "non-entity," since there would be no useful industry-wide trending information for the final two years?

See answer to Question (3) above.

MR. BROOKS' QUESTION FOR THE RECORD FOR MR. HUNTER

Question

Insurance companies and others argue that the historical loss statistics on which future loss estimates and premium prices are based must be gathered collectively, perhaps even on an industrywide basis, in order to be reliable. As you know, the committee has accepted this argument as legitimate, and H.R. 9 leaves collection and sharing of this statistical data base completely shielded under McCarran-Ferguson.

Often, however, some in the insurance industry seem to be making a similar argument with respect to trending forecasts -- that the information used in trending is such that it is only reliable if obtained and processed collectively. Could you explain to us what information used in the trending process, if any, needs to be gathered collectively in order to be reliable? (You can exclude, of course, any information obtained directly from the statistical data base, since H.R. 9 leaves that data base completely shielded under McCarran-Ferguson.)

Answer

It is true that trend data should be allowed to be obtained and processed collectively. These data are such things as quarterly average paid claims costs and paid claims frequencies. H.R. 9 allows that data to be collected under the statistical data base. Since other factors insurance companies may rely upon in deciding on trend factors are government produced information (e.g., CPI movement), the insurance data is all that is required from the statistical data base.

Thus, H.R. 9 allows all the required information to make a trend judgement to be collected and disseminated jointly. All H.R. 9 prohibits is joint speculation about the implications of this information for the future.

REPUBLICAN MEMBERS QUESTIONS FOR THE RECORD

(1) How many members does the National Insurance Consumer Organization (NICO) have? How does an individual or organization become a member of NICO? How much are the dues? What is your relationship with Public Citizen? How is your organization financed? Do you received and funds from Public Citizen or any other public interest group? How much? What is the annual budget of NICO? How is that money spent? Are you or any of your employees registered lobbyists?

(2) Following the Supreme Court's decision on June 25 in the Hartford v. California case, you were quoted as expressing concern about the Court's interpretation of the boycott exemption in the McCarran Act. Could you elaborate on your views regarding their interpretation of what constitutes a boycott under the McCarran-Ferguson Act?

(3) For the Subcommittee's record, could your discuss your overall reaction to the recent Supreme Court decision?

(4) What effect do litigation costs have on the cost of liability insurance? Couldn't tort reform lower liability insurance costs?

Answers

(1) 25,000. Pays $25 and submits an application. No legal relationship with Public Citizen. Dues, foundation grants, sales of books on how to buy insurance. No, although a grant from Consumers Union was once received and we have done some contract work for AARP. Our annual budget is $100,000. Salaries, rent, travel, overhead. Yes.

(2) & (3)

The Supreme Court decision in the Hartford Fire Insurance Co., et al. case (under which four huge U.S. insurance companies conspired with foreign reinsurers of the size and clout of Lloyd's of London to make broad insurance coverage unavailable to businesses in the United States) that there is no antitrust immunity -- was obviously correct. But the very fact that it took 100 pages of obtuse jurisprudence, in two 5 to 4 decisions, after two lower courts disagreed totally, demonstrates that the insurance industry's special interest antitrust law exemption remains a serious hazard to America's financial health. Their narrowing of what constitutes a boycott is of serious concern.

There is no question that if two butcher shops entered into this sort of anti-competitive conspiracy, they would have been slaughtered at the court, unanimously.

Individuals and small businesses are the most vulnerable to the kinds of pressure and coercion the insurers were guilty of. Hartford, Allstate, Aetna and CIGNA wanted to stop insuring businesses against pollution and other claims. But they knew they could not sell poor policies like these if other insurance companies did not do likewise. The naked attempt to squash competition that ensued was required since to do otherwise would leave the conspirators unable to face the rigors of competitors who offered better policies. Had the Supreme Court abided this behavior, it would have made a mockery of the U.S. Antitrust law. The fact they struggled so with it is a serious wake up call to Congress that America needs to deal with the McCarran-Ferguson Act's excessive antitrust exemption.

How can you manage competition in health insurance if insurers can legally fix prices, as they may today, or collude to limit policy coverage as in this case? How can America afford a continuation of the McCarran-Ferguson Act?

(4) Litigation costs do influence liability insurance costs. While it is possible that taking away people's rights might lower corporate expense, it is not likely that insurers will pass through such savings absent a specific requirement in the law lowering peoples' rights to that effect.

Consumers Union
Publisher of Consumer Reports

To: Committee on Judiciary
Fr: Linda Lipsen, Legislative Director
Consumers Union
Re: Response to question for the record in connection with Subcommittee Hearing on July 29, H.R. 9, the Insurance Competitive Pricing Act of 1993."

(1) In your view, what is the appropriate role of the federal government regarding the regulation of insurance? Do you believe that the federal government should establish minimum solvency standards? What about rate setting?

Insurance is a product which moves in interstate commerce, though is regulated by the states. Consumers Union believes that the states should continue to play the dominant role in regulating the business of insurance, but the federal government should enunciate some minimum standards in order to provide a floor of protection for our nation's consumers in this complex marketplace. Areas where minimum federal standards are needed include: capital and surplus requirements, including standards applicable to reinsurers and foreign insurers, the liquidation and receivership system, guaranty fund protection, and consumer disclosure and protection. The federal government could also play a useful role in the collection and analysis of data.

Though we support the efforts of the National Association of Insurance Commissioners to assure uniformity in solvency regulation through their financial accreditation process, the system is inherently weak. The NAIC is only a voluntary organization wholly without enforcement authority. Legislation governing the insurance industry must still be approved by legislative bodies and chief executives---which is always an uncertain process. For all its strengths, the accreditation process is moving very slowly, with less than half the states accredited at this time. The failure of states to follow the lead of the NAIC in this important solvency area underscores the need for a more pronounced federal role in this area.

Rate setting: In a fully competitive market, (not the present insurance marketplace), rate setting would not be necessary because competitive forces would operate to establish a pricing structure fair to consumers. Our strong preference is that McCarran be repealed so that market forces work to make prices more consumer friendly and that states set rates only in the face of market break down.

Washington Office
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Rick K. Nelson's Responses to:
Republican Members Questions For The Record

(1) Did you have a contract with Prudential, Metropolitan and TransAmerica? Did any of these contracts require you, as their agent, to submit any proposed advertisements for company approval, prior to their use? If so, was your termination based upon breach of contract?

Answer

I did have insurance brokerage contracts with Prudential, Metropolitan, and TransAmerica. Illinois (my resident state) insurance law requires that if any advertisement includes the name of an insurance company or premiums for insurance coverage that the insurance company's approval must be obtained by the agent/broker before the ad can be placed in a publication. The sales agreements and/or contracts that I had with the three companies only required prior approval of ads that used their company name. For these reasons my ads never contained the name of any insurance company nor did they ever list the premiums of any insurance policies. The ads merely described the services that my firm would provide as an independent life insurance broker. I also had my ads reviewed by several different state insurance departments for their further approval. No, my contracts were not terminated based upon breach of contract. My contracts were terminated at will. There was never any argument in court that I breached my contracts with the insurance companies. The insurance companies successfully argued that my contracts were terminable at will and the companies terminated them pursuant to the contractual provisions.

(2) Have you filed complaints with any of the state insurance departments about being terminated by these companies for discounting and rebating? What was their response? Please furnish copies of their responses for the record.

Answer

I did not file any formal complaints with any state insurance departments.

(3) Isn't the problem you have really directed at state antirebate laws? A change in the McCarran Act won't alter those state laws. Aren't your complaints better directed at the various state legislatures?

Answer

I have no problem with the current state antirebate laws and I have never worked nor publicly advocated that these laws be changed. In my resident state of Illinois it is illegal for an agent or broker to pay a portion of his or her commissions to the insurance buyer as an inducement for the business. That would be an illegal rebate and I fully support that law. The types of insurance policies that I sold in Illinois were properly filed with the state insurance commissioner and they were available for sale. The policies did have a lower cost to the consumer and correspondingly, paid me a lower commission. The lower cost and resulting lower commission came about because the insurance company had made the proper filings with the state insurance department. I have included a copy of a 1991 report prepared by the National Association of Life Underwriters which explains how I was able to offer lower cost policies and these were not illegal rebates.

I am pleased to read your statement that changes in the McCarran Act would not alter

existing state laws concerning rebates. I believe that it is important that the state action doctrine apply to this matter.

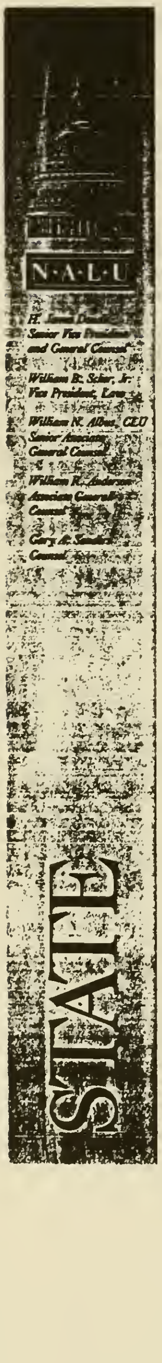
I don't think my complaints would be better directed at the state legislatures since I do not want to see changes in the current state laws regarding rebates.

(4) The McCarran Act doesn't exempt insurance companies from acts of boycott, coercion and intimidation. Have you brought suit on any of these grounds under the federal antitrust laws. If not, why not?

Answer

I did not file a suit alleging violation of the federal antitrust laws based upon the advice I received from my legal counsel. I was advised that the insurance companies would claim that my contracts were terminated at will and I did not have any proof that the three insurance companies conspired in reaching a conclusion that they should cancel my contracts. The cancellations were also conveniently separated by three month intervals which I was advised would strengthen the insurance company's defense of independent action.

I did consult several law firms on the matter and I received the advice not to pursue an antitrust lawsuit by more than one firm. The law firm that I did rely upon to file my suit against the three companies informed me after extensive research that they would not file an antitrust lawsuit for fear of sanctions.



LEGISLATIVE REPORT

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SLR 91-15 **July 3, 1991**

SPECIAL

DISCOUNT INSURANCE BROKER FILES LAWSUIT AGAINST MAJOR INSURERS

On May 6, 1991, Illinois insurance broker Rick K. Nelson filed a lawsuit against three major insurers, Metropolitan Life Insurance Company, The Prudential Insurance Company of America and Transamerica Occidental Life alleging they had canceled agreements with him because he advertised their life insurance products at a discount.

Mr. Nelson maintained that an independent insurance broker can pass savings on to consumers by:

1. a commission rebate which is legal only in Florida and California; and
2. an "internal discount" which is legal in all states.

According to the complaint, an internal discount is a "reduction of premium by changing specific policy provisions and/or applicable filings, which result in lower premiums or higher cash values while providing a higher death benefit". These internal discounts or so-called "internal rebates" result, the complaint averred, from insurance agents reducing their commissions and passing the savings on to consumers. The complaint declared the discount is legal because it is part of the insurance contract or made part of the contract by a policy rider or applicable filing with the state insurance department.

Mr. Nelson claims that "discounting is a part of every industry". He wishes to educate consumers on how to buy life insurance at a discount and assures that his efforts will produce a healthy atmosphere for consumers and stimulate competition within the industry.

The complaint additionally asserted that independent discount brokers authorized to sell the defendants' life insurance products pose a competitive threat to the continuing existence of the companies' network of so-called "home agents", i.e., licensed insurance brokers or agents employed or contracted to act exclusively for the defendants.

Although this case is essentially an action for breach of contract, Mr. Nelson has raised a genuine question of what constitutes an insurance rebate. The confusion arises because a "reduced" premium policy is thought by some to be a type of rebate. Nothing could be further from the fact.

The act of rebating, as defined by the NAIC Model Unfair Trade Practices Act, is "... knowingly permitting or offering to make or making any life insurance policy or annuity, or accident and health insurance, or agreement as to such contract *other than as plainly expressed in the policy* issued thereon, or paying or allowing, or giving or offering to pay, allow, or give, directly or indirectly, as inducement to such policy, any rebate of premiums payable on the policy, or any special favor or advantage in the dividends or other benefits thereon, or any valuable consideration or inducement whatever not specified in the policy; or giving, or selling, or purchasing or offering to give, sell or purchase as inducement to such policy or annuity ... *or anything of value whatsoever not specified in the policy.*" [emphasis added]. Thus, only extracontactual enticements to induce an individual to purchase insurance are considered rebates and therefore prohibited practices.

THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS ■ WASHINGTON, D.C.

As the complaint points out, policies with lower premiums that reduce insurance costs do exist. These are not, however, rebates. Indeed, they are not even technically "discounted" although the complaint gratuitously defines them as such. Lower premiums result from specific factors such as decreased administrative expenses, reductions inherent in economies of scale, combinations of coverage arising from riders and/or diverse types of coverage, and similar dissimilarities including different commission rates for different policies and/or different types of coverages, i.e. whole, term, universal, or group life.

Mr. Nelson's lawsuit coupling the concept of "discount policies" with rebating merely increases the potential of confusing the currently clouded issue of rebating and the reasons why the latter practice is prohibited by all but two states. Policies with lower premiums are not discriminatory and are available to the buying public in a variety of coverages. Contrariwise, unregulated rebates are secret and selective and discriminatory and anti-competitive and anti-consumer.

In Florida rebates are stringently controlled and even in California are subject to the unfair discrimination provisions of the Insurance Code and the anti-competitive prohibitions of the Business and Professional Code.

Unrestricted rebates would wreck the regulatory mechanism for determining unfair discrimination because it would become impossible to ascertain whether equal rebates on identical policies were being offered to individuals in the same class or category of risk. Certainly policy forms filed with insurance departments do not suffer from these disabilities.

* * * * *

For further information, please contact William N. Albus, Senior Association General Counsel, The National Association of Life Underwriters, 1922 F Street, NW, Washington, D.C. 20006, (202) 331-6021.

QUESTIONS AND ANSWERS FOR WILLIAM L. POLLARD, BOARD OF GOVERNORS, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS ON BEHALF OF THE NAII, AAI, ACLI, HIAA, NALU, NAMIC, AND NAPIA

Q. 1. How essential is trending information to your member companies? How exactly is trending information used? For what lines of insurance is trending information most frequently used?

A. 1. Trending information is crucial to all our member companies, especially the small to medium size companies. The insurance product is one that is priced before the actual cost is known. The trending of historical costs and accident rates, then extrapolating them into the future allows the price estimation to take place. A very large and credible data base is essential for producing trends. Smaller companies with less data would be forced to base estimates on more volatile and less indicative trends. All lines of business utilize trending procedures in one fashion or another. Automobile insurance is probably most dependent on trends because both inflationary pressures and accident rates are crucial in setting future rates.

Q. 2. H.R. 9 does not repeal that portion of the McCarran-Ferguson Act which specifically grants the states the primary role with respect to the regulation of insurance. If that is true, why does your organization believe that the enactment of H.R. 9 threatens the "current system of state regulation of insurance?" H.R. 9 does not mean that the federal government will directly regulate insurer solvency or rates, does it?

A. 2. McCarran allocates power between the federal government and the states regarding the responsibility for regulating the business of insurance. Repeal of, or changes in, McCarran will alter that allocation, replacing the current system of state regulation with a system of dual federal-state regulation.

H.R. 9 threatens the current system of state regulation of insurance because it would subject many vital and pro-consumer industry practices, which are already state regulated, -- such as ratemaking, packaging of insurance products and pooling for hard-to-place risks -- to unwarranted and duplicative regulation under federal antitrust laws. In addition, H.R. 9 provides that insurance trade practices, which are pervasively regulated at the state level, would be subject to review and regulation by the Federal Trade Commission.

Q. 3. Mr. Price, in his testimony before the subcommittee stated that "because of the atmosphere created by" the McCarran Act the insurance industry lacks the "kind of innovation and diversification of product and services" that are present in other industries (i.e., industries subject to the antitrust laws.) Do you think that this is an accurate characterization of the insurance industry? If not, why not?

A. 3. No, the McCarran Act fosters competition and innovation in the marketplace. Under the current system, entry barriers are low and the market is extremely competitive with a wide variety of companies and products. Innovation is stimulated in this marketplace environment. New market entrants and niche companies, which have sprung up to fill a need or vacuum in the market, simply would not have been able to thrive and survive without McCarran. Many of NAII's member companies got started that way by groups of farm organizations, military officers, motor clubs and so on. Additional examples of innovation in this industry abound, from the evolution of the market away from bureau rating to open competition, to policy forms and coverages, to marketing methods and claims handling. The fact is, H.R. 9 will stifle innovation, not increase it, because it will drive out the innovators and lessen competition in the industry.

MR. BROOKS QUESTION FOR THE RECORD FOR MR. PRICE

As a State official yourself, do you believe that applying the Federal antitrust laws to the business of insurance would in any way undermine the State's ability to regulate for the benefit of consumers?

For a variety of reasons I do not believe that applying the federal antitrust laws to the business of insurance would undermine the State's ability to regulate for the benefit of consumers. The antitrust laws themselves operate for the benefit of consumers. Accordingly, the decision to apply the antitrust laws to the business of insurance is a policy decision made for the benefit of consumers. Additionally, even if a state found it necessary to regulate aspects of the insurance industry in a manner that was inconsistent with the antitrust laws, the state action doctrine would permit that regulation so long as the state affirmatively articulated the policy of displacing competition and actively supervised the conduct mandated by that regulatory regime. Finally, outside of the few areas where the courts have declared certain activity to be unlawful <u>per se</u>, the antitrust laws are sufficiently flexible to accommodate the <u>reasonable</u> collaborative efforts of this industry without undue interference or uncertainty.

REPUBLICAN MEMBERS' QUESTIONS FOR THE RECORD FOR MR. PRICE

1. In your view if H.R. 9 is enacted, will insurers be able to utilize the "state action" defense in all 50 states and the District of Columbia? Could there be states that will not meet the two-part test of state action?

The so-called state action defense or exemption would be available for use in all 50 states and the District of Columbia. Whether the current insurance regulations of each of the 50 states and the District of Columbia would pass muster under the two-part state action test should not be a major factor in assessing whether H.R. 9 should be adopted to permit the application of the federal antitrust laws to the business of insurance. H.R. 9 makes express provision for a transition period during which the 50 states and the District of Columbia will have ample opportunity to determine which of their insurance regulations (as with all of their other regulations) do or do not (should or should not) meet the state action test.

2. You use the phrase "effectively supervises" as a way of describing the _Midcal_ test on page 3 of your testimony. As you know, in interpreting the state action doctrine in _Midcal_ the Court used the phrase "_active_ state supervision." Does "effectively supervises" mean something different that "active state supervision?" What do you intend it to mean?

I intended the phrase "effectively supervises" to mean the same thing as the phrase "active state supervision" used by the courts in _Midcal_ and its progeny. I chose the phrase "effectively supervises" for its more robust connotation that the "active state supervision" required by the state action doctrine must engender confidence that private actions subject to such supervision actually conform to the state's sovereign policy. Private parties should not be excused from the legal consequences of their actions simply because their acts were undertaken within the actual or presumptive knowledge some public official. Although the Supreme Court in _F.T.C. v. Ticor Title Insurance Co._, did not evaluate the quality of supervision required, it did insist that the state's role be "deliberate" and "substantial."

3. In your view, what forms of state regulation of insurance would be determined to be active (or, "effective")? What about the "file-and-use" states or the "open competition" states? Along the lines of the Ticor case, mightn't the courts rule that those forms of regulation are not "active" enough?

Antitrust analysis, including state action analysis, is particularly dependent on the actual facts to which it is applied. By its nature, the state supervision prong of the state action analysis requires state participation and review of private actions sufficient to assure that particular private behavior conforms to mandated state standards. Unlike McCarran analysis, state action analysis is more concerned with the fact of the regulatory review rather than the form of the regulatory review. Accordingly, depending upon the particular facts, I could envision circumstances where the courts might not find state action protection available regardless of whether the regulatory system was characterized as "file and use," "open competition" or "prior review." In the absence of active state supervision; the commercial, collaborative actions of competitors, including those of insurers, should be tested for their legality under the antitrust laws.

4. Do you believe that insurance companies deserve a fair or reasonable return on their investment--i.e., a profit? Can insurance rates be reduced to levels where it no longer makes good business sense for a company to insure particular risks? In circumstances where rates are reduced to such low levels that insurance companies can no longer make a reasonable rate of return, do you believe that they should be required to continue to underwrite risks in that particular state?

Historically, the insurance industry has been the subject of varying degrees of state regulation. The ordinary insured is in no position to assess the underwriting skill and financial responsibility of any given insurer. State regulations have, therefore, established benchmarks and safety valves to protect the interests of insurance consumers. This regulatory intervention in the market has created a host of tensions between insurers and regulators over what constitutes a fair return, what risks should be borne by stockholders rather than by insureds and the conditions under which an insurer may abandon a state's consumers when it does not agree with the state's regulatory policy. Tension between the regulators and the regulated based upon different motives and responsibilities exist in every regulatory system. It is that very tension which makes the active state supervision prong of the Midcal test important. It is that very tension which makes the state action test for the antitrust legality of insurance companies' activities most appropriate.

5. Does NAAG continue to prefer outright repeal of the McCarran Act? In your view, is the safe harbor approach unnecessary?

NAAG has adopted a resolution supporting the outright repeal of the McCarran Act. NAAG has never taken a formal position on either the existence of safe harbors for the insurance industry or the wisdom of particular safe harbors. I personally believe that federal safe harbors, unless subordinated to state regulatory decisions, could be a source of confusion. The Supreme Court has noted on more than one occasion that the federal antitrust laws were in part designed to supplement the antitrust laws of the states. Both the current McCarran Act and H.R. 9 continue to acknowledge the primacy of state regulation of the insurance industry. An unqualified federal safe harbor might easily operate in a manner which would neither be supplementary to state law nor consistent with the primacy of state regulation of the insurance industry.

Republican Members Questions For the Record

Answers for:
John M. Rector, who appeared on behalf of the National Association of Retail Druggists/Small Business Legislative Council.

(1) **Shouldn't Congress wait and see what is contained in the Clinton Administration's health care proposal before we move ahead on legislation like H.R.9?**

There is no need to delay Subommittee action on H.R.9 pending the introduction of President Clinton's Health Care Reform legislation. It was introduced as H.R. 3600 on November 20, 1993. Title V - Quality and Consumer Protection, includes Subtitle F - McCarran-Ferguson Reform. It's Section 5501 entitled "Repeal of Exemption for Health Insurance" reads as follows:

Subtitle F—McCarran-Ferguson Reform

SEC. 5501. REPEAL OF EXEMPTION FOR HEALTH INSURANCE.

(a) IN GENERAL.—Section 3 of the Act of March 9, 1945 (15 U.S.C. 1013), known as the McCarran-Ferguson Act, is amended by adding at the end the following:

"(c) Notwithstanding that the business of insurance is regulated by State law, nothing in this Act shall limit the applicability of the following Acts to the business of insurance to the extent that such business relates to the provision of health benefits:

"(1) The Sherman Act (15 U.S.C. 1 et seq.).

"(2) The Clayton Act (15 U.S.C. 12 et seq.).

"(3) Federal Trade Commission Act (15 U.S.C. 41 et seq.).

"(4) The Act of June 19, 1936 (49 Stat. 1526; 15 U.S.C. 21a et seq.), known as the Robinson-Patman Antidiscrimination Act.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the first day of the sixth month beginning after the date of the enactment of this Act.

Republican Members Questions For the Record

Answers for:
John M. Rector, who appeared on behalf of the National Association of Retail Druggists/Small Business Legislative Council.

(2) **Does NARD see a relationship between health care cost containment and the overall economic health of the insurance industry? Might not the protections for insurers contained in the McCarran-Ferguson Act become even more important or necessary, if the health insurance industry is to respond to an entirely new, restructured health care industry?**

Yes, we see a relationship. The elimination of the ability of the Health Care Insurance Industry to engage in price fixing, tying arrangements and other anticompetitive activities will help assure a competitive proconsumer environment more consistent with health care cost containment objectives and other consumer interests.

It is noteworthy that, as I indicated in our statement, that former President Bush in his February 6, 1992 health care message to Congress entitled "Comprehensive Health Reform Program", observed:

> "PPOs, HMOs and Other Pooling Arrangements of Providers" - The emergence of managed care is creating new issues in health care. For instance, if physicians in an area band together to form a PPO, thus fostering price reductions and managed care, it may be alleged that they are nonetheless reducing the number of competitors for physician services in the marketplace. <u>At the same time, diligent enforcement of the antitrust laws is necessary to prevent price fixing and illegal tie-ins in the provision of health care. Reducing the fear of liability for certain beneficial activities while maintaining the deterrent effect of the antitrust enforcement agencies, particularly the Department of Justice and the Federal Trade Commission.</u>

Perhaps even the Bush White House had reconsidered the importance of applying antitrust laws to the insurance industry. We hope so, but in any case, it is good public policy to apply the rules of competition to all sectors of the market equally.

Republican Members Questions For the Record

Answers for:
John M. Rector, who appeared on behalf of the National Association of Retail Druggists/Small Business Legislative Council.

(3) **If H.R.9 were enacted, what types of legal actions against insurers do you anticipate that your members would be likely to pursue? Specifically, what violations of the antitrust laws occur because of pharmacy reimbursement policies?**

It is our hope and expectation that, once enacted, the insurance industry would comply with the antitrust laws. To the extent that some degree of lawlessness occurred subsequent to enactment, it would not surprise us if requisite litigation involved price fixing and tying arrangement violations. It is presently such conduct that is exempt as distinguished from the actual pharmacy third party contracts.

Republican Members Questions For the Record

Answers for:
John M. Rector, who appeared on behalf of the National Association of Retail Druggists/Small Business Legislative Council.

(4) Is it the view of the National Association of Retail Druggists that by encouraging the use of mail order pharmacies that insurers are involved in anticompetitive activities that violate the antitrust laws? If so, could you specifically explain how that is true?

Typically the nature of the "encouragement" involved with the use of mail order pharmacies is that consumers are, in effect, coerced to select a mail order pharmacy in lieu of other pharmacy competitors. In the extreme, choice of provider is totally denied. More typically, a covered employee would be required to meet a $250-$500 deductible and a $10 per prescription co-payment if he or she desired to access pharmacies that we represent. In contrast, there would be no co-payment or deductible for mail order pharmacies, who, incidentally, are totally unregulated, resulting in disenfranchisement of such employees from any appropriate local or state legal remedies.

As near as we can determine, these discriminatory contracts are enabled through a variety of questionable practices including possible price fixing, tying arrangements, and price discrimination for our competitors.

Several recent law suits echo our findings and concerns. One was filed by the Honorable Arlin M. Adams in the U. S. District Court for the Middle District of Pennsylvania; Rite Aid Corporation, etal., v. American Home Products Corporation, etal., and the other was filed by the Honorable Joseph L. Alioto in the U. S. District Court in the Northern District of California, filed August 11, 1993; Lawson-Dyer Pharmacy and all others similarly situated, v. Medco Containment Services, Inc., etal.

Republican Members Questions For the Record

Answers for:
John M. Rector, who appeared on behalf of the National Association of Retail Druggists/Small Business Legislative Council.

(5) **Incentives to use mail order pharmacies contained in insurance policies are part of the overall health care cost containment effort. Aren't efforts aimed at lower health care costs supported by your members?**

Yes, NARD members and individual SBLC Association members are very supportive of cost containment. In fact, SBLC's position on Health Care Reform includes appropriate cost controls for providers and others, and in addition, supports global budgeting.

Unfair incentives for our competitors who have selected non-traditional, unregulated distribution as their hallmark do not reduce overall costs. In fact, corporate purchasers see little of the difference between a typical product acquisition cost and the discriminatory acquisition cost available to our mail order competitors. Additionally, the pharmaceutical corporations provide mail order pharmacies such acquisition costs not based on economies of scale and cost-shift to community retail pharmacies, resulting in annual increases in the price of prescription drugs to most American consumers three to four times the CPI.

The National Association of Retail Druggists support limiting pharmaceutical manufacturer pricing increases to the CPI.

Republican Members Questions For the Record

Answers for:
John M. Rector, who appeared on behalf of the National Association of Retail Druggists/Small Business Legislative Council.

(6) **NARD has advocated that the states should adopt so-called "Freedom of Choice" legislation. It is my understanding that such laws have been enacted in some states (Idaho, Arkansas). Could you explain what these laws say and what impact they have had on the overall cost of health care? Doesn't the consumer, on average, pay more for drugs if such statutes are enacted?**

Equal access or consumer pharmacy freedom of choice laws have been enacted in many states. [See enclosed list] As if dictated by Adam Smith himself, these laws help sustain an already competitive retail pharmacy marketplace. They do so by assuring that consumers are free to select amongst competitors. In the retail pharmacy marketplace, the average markup according to the Lilly Digest is thirty percent (30%); well below that typical of all small businesses, especially those involved in the delivery of health care.

We are unaware of any credible evidence that consumers pay more in states that assure to consumers their choice of pharmacy provider. Ironically, many of our competitors who are the beneficiaries of price discrimination actually bill consumers and other buyers, including Medicare, Medicaid, and Third Party payors, multiples of the average retail price. [See Arlin Adams' "Selected Price Comparisons".

Republican Members Questions For the Record

Answers for:
John M. Rector, who appeared on behalf of the National Association of Retail Druggists/Small Business Legislative Council.

(7) **Isn't your organization really after changes in another antitrust statute -- the Robinson-Patman Act? Didn't NARD request an investigation by this Subcommittee of certain pricing practices of drug companies? What kind of an inquiry was sought? Are you alleging price discrimination and, if so, can it be documented?**

The SBLC/NARD have repeatedly called for a full enforcement of the Robinson-Patman Act. Such enforcement, as well as Clayton Act and Sherman Act provisions, would provide a long-overdue, strong deterrent and restitution for those victimized by the unfair pricing practices of the pharmacuetical industry. Yes; NARD did request a Subcommittee investigation.

Enclosed is a copy of the June 22, 1989 request to the GAO from Chairman Jack Brooks, as well as the August 2, 1990 GAO final response to Chairman Jack Brooks.

The August 1, 1990 correspondence, includes an enclosure listing the pharmaceutical corporations that refused to cooperate. It appears that short of issuing supoenas, pharmaceutical manufacturers and wholesalers will continue not to cooperate with such inquiries.

The evidence of price discrimination and pharmaceutical distribution is wide-spread and relatively well-documented. An especially good new source of such documentation has been made available because of the 1990 enactment of the Medicaid Anti-discriminatory Pricing Amendment in the 1990 OBRA. In short, as a consequence of requiring manufacturers to provide Medicaid their "best price", and the related determination of "average manufacture price", extensive and detailed profiles of such discrimination is available on a state to state basis.

In addition to reconsidering the issuance of appropriate subpoenas, we urge the Subcommittee to acquire, on a confidential basis, this invaluable data on price discrimination from the Secretary of Health and Human Services.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

RITE AID CORPORATION, REVCO D.S., INC., THRIFTY CORPORATION, PERRY DRUG STORES, INC., K & B, INCORPORATED, KERR DRUG STORES, INC., SNYDER'S DRUG STORES, INC., THRIFTY DRUG STORES, INC., THE BARTELL DRUG COMPANY, TAYLOR DRUG STORES, INC., SHELDON H. BLOOM d/b/a DANIELSON MEDICAL ARTS CENTER, DRUG EXPRESS PHARMACIES, INC. d/b/a OTTO DRUG EXPRESS, JAY HARRIS d/b/a MEDICAP, MICHAEL HART d/b/a HART SNYDER DRUG, PAUL IVERSON d/b/a IVERSON CORNER DRUG, DAVID KOHLER d/b/a HUNT SILVER LAKE DRUG, LAKE CITY DRUG, INC.,	:	FILED OCT 14 1993 PER ______ HARRISBURG, PA DEPUTY CLERK CIVIL ACTION NO. 4 : CV-93-1580 NARD Legislative Defense Fund 205 Daingerfield Road Alexandria, VA 22314

RICHARD C. OFTEDAHL
d/b/a OFTEDAHL DRUG,

SETZER PHARMACY, INC., and

RICHARD C. SUNDBERG
d/b/a SUNDBERG PHARMACY,

Plaintiffs,

vs.

AMERICAN HOME PRODUCTS
CORPORATION,

CIBA-GEIGY CORPORATION,

G. D. SEARLE & CO.,

GLAXO INC.,

PFIZER, INC.,

SCHERING-PLOUGH CORPORATION,

SMITHKLINE BEECHAM
PHARMACEUTICALS CO.,

MEDCO CONTAINMENT SERVICES, INC.,

NATIONAL PHARMACIES, INC., and

PAID PRESCRIPTIONS, INC.,

Defendants.

COMPLAINT

Plaintiffs bring this civil action against the Defendants and allege as follows:

JURISDICTION

1. This is a private antitrust action brought under Sections 4 and 16 of the Clayton Act, 15 U.S.C. §§ 15 and 26, alleging violations of the federal antitrust laws, specifically Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, and Sections 2(a), (d), and (f) of the Robinson-Patman Act, 15 U.S.C. §§ 13(a), (d), and (f), and of the common law. The Court has jurisdiction over this action pursuant to 28 U.S.C. §§ 1331, 1337(a), and 1367(a), and 15 U.S.C. §§ 2, 15, and 26.

VENUE

2. Venue is proper in this judicial district pursuant to 15 U.S.C. §§ 15, 22, and 26 and 28 U.S.C. § 1391(b) because each of the defendants resides, transacts business, is found, and has agents in this district, and because a substantial part of the events or omissions giving rise to Plaintiffs' claims occurred in this district.

Office of General Counsel
NARD

THE PARTIES

3. Plaintiff Rite Aid Corporation ("Rite Aid") is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Cumberland County, Pennsylvania. Rite Aid owns and operates over 2,500 drugstores in the 22 contiguous eastern states, bordered on the west by Michigan, Indiana, Kentucky, Tennessee, and Alabama, and in the District of Columbia.

4. Plaintiff Revco D.S., Inc. ("Revco") is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Twinsburg, Ohio. Revco owns and operates over 1,100 drugstores in Georgia, Maryland, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia, and West Virginia.

5. Plaintiff Thrifty Corporation ("Thrifty") is a corporation organized and existing under the laws of the State of California, with its principal place of business in Los Angeles, California. Thrifty owns and operates over 500 drugstores in California.

6. Plaintiff Perry Drug Stores, Inc. ("Perry") is a corporation organized and existing under the laws of the State of Michigan, with its principal place of business in Pontiac, Michigan. Perry owns and operates over 200 drugstores in Michigan.

7. Plaintiff K & B, Incorporated ("K & B") is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New Orleans, Louisiana. K & B owns and operates over 170 drugstores in Alabama, Florida, Louisiana, Mississippi, Tennessee, and Texas.

8. Plaintiff Kerr Drug Stores, Inc. ("Kerr") is a corporation organized and existing under the laws of the State of North Carolina, with its principal place of business in Raleigh,

North Carolina. Kerr owns and operates over 95 drugstores in North Carolina and South Carolina.

9. Plaintiff Snyder's Drug Stores, Inc. ("Snyder") is a corporation organized and existing under the laws of the State of Minnesota, with its principal place of business in Minnetonka, Minnesota. Snyder owns and operates over 80 drugstores in Iowa, Michigan, Minnesota, and Wisconsin.

10. Plaintiff Thrifty Drug Stores, Inc. ("Thrifty Drug") is a corporation organized and existing under the laws of the State of Minnesota, with its principal place of business in Minneapolis, Minnesota. Thrifty Drug owns and operates over 40 drugstores in Iowa, Minnesota, Montana, North Dakota, and South Dakota.

11. Plaintiff The Bartell Drug Company ("Bartell") is a corporation organized and existing under the laws of the State of Washington, with its principal place of business in Seattle, Washington. Bartell owns and operates over 35 drugstores in Washington.

12. Plaintiff Taylor Drug Stores, Inc. ("Taylor") is a corporation organized and existing under the laws of the State of Kentucky, with its principal place of business in Louisville, Kentucky. Taylor owns and operates over 30 drugstores in Indiana and Kentucky.

13. Plaintiff Sheldon K. Bloom is an individual doing business as Danielson Medical Arts Center. Mr. Bloom owns and operates a drugstore in Minneapolis, Minnesota.

14. Plaintiff Drug Express Pharmacies, Inc. ("Drug Express") is a corporation organized and existing under the laws of the State of Minnesota, doing business as Otto Drug Express. Drug Express owns and operates a drugstore in Belle Plaine, Minnesota.

15. Plaintiff Jay Harris is an individual doing business as Medicap. Mr. Harris owns and operates a drugstore in Kasson, Minnesota.

16. Plaintiff Michael Hart is an individual doing business as Hart Snyder Drug. Mr. Hart owns and operates a drugstore in Forest Lake, Minnesota.

17. Plaintiff Paul Iverson is an individual doing business as Iverson Corner Drug. Mr. Iverson owns and operates a drugstore in Bemidji, Minnesota.

18. Plaintiff David Kohler is an individual doing business as Hunt Silver Lake Drug. Mr. Kohler owns and operates a drugstore in Rochester, Minnesota.

19. Plaintiff Lake City Drug, Inc. ("Lake City) is a corporation organized and existing under the laws of the State of

Minnesota. Lake City owns and operates a drugstore in Lake City, Minnesota.

20. Plaintiff Richard C. Oftedahl is an individual doing business as Oftedahl Drug. Mr. Oftedahl owns and operates a drugstore in Madison, Minnesota.

21. Plaintiff Setzer Pharmacy, Inc. ("Setzer Pharmacy") is a corporation organized and existing under the laws of the State of Minnesota. Setzer Pharmacy owns and operates a drugstore in St. Paul, Minnesota.

22. Plaintiff Richard C. Sundberg is an individual doing business as Sundberg Pharmacy. Mr. Sundberg owns and operates a drugstore in St. Paul, Minnesota.

23. Defendant American Home Products Corporation ("American Home") is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York. American Home is the manufacturer of numerous brand name prescription drugs, including but not limited to the drugs Aygestin, Inderal, Isordil, Lodine, Micro-K, Mysoline, Orudis, Premarin, Quinidex Ext, Sectral, Tenex, and Wytensin. American Home sells these and other drugs throughout the United States, including in this judicial district.

24. Defendant Ciba-Geigy Corporation ("Ciba-Geigy") is a corporation organized and existing under the laws of the State

of New York, with its principal place of business in Ardsley, New York. Ciba-Geigy is the manufacturer of numerous brand name prescription drugs, including but not limited to the drugs Brethaire, Brethine, Estraderm, Lioresal, Lotensin, Rimactane, Slow-K, Tegretol, Ten-k, Transderm-Nitro, and Tofranil. Ciba-Geigy sells these and other drugs throughout the United States, including in this judicial district.

25. Defendant G.D. Searle & Co. ("Searle") is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Skokie, Illinois. Searle is the manufacturer of numerous brand name prescription drugs, including but not limited to the drugs Aldactazide, Aldactone, Calan, Calan SR, Cytotec, Kerlone, and Nitrodisc. Searle sells these and other drugs throughout the United States, including in this judicial district.

26. Defendant Glaxo Inc. ("Glaxo") is a corporation organized and existing under the laws of the State of North Carolina, with its principal place of business in Research Triangle Park, North Carolina. Glaxo is the manufacturer of numerous brand name prescription drugs, including but not limited to the drugs Beclovent, Beconase, Beconase AQ, Trandate, Ventolin, and Zantac. Glaxo sells these and other drugs throughout the United States, including in this judicial district.

27. Defendant Pfizer, Inc. ("Pfizer") is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York. Pfizer is the manufacturer of numerous brand name prescription drugs, including but not limited to the drugs Diabinese, Glucotrol, Procardia, Vibramycin, and Vistaril. Pfizer sells these and other drugs throughout the Unites States, including in this judicial district.

28. Defendant Schering-Plough Corporation ("Schering") is a corporation organized and existing under the laws of the State of New Jersey, with its principal place of business in Kenilworth, New Jersey. Schering is the manufacturer of numerous brand name prescription drugs, including but not limited to the drugs K-Dur, Nitro-Dur, Normodyne, Proventil, Theo-Dur, Vancenase, Vancenase AQ, and Vanceril. Schering sells these and other drugs throughout the United States, including in this judicial district.

29. Defendant SmithKline Beecham Pharmaceuticals Co. ("SmithKline") is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Philadelphia, Pennsylvania. SmithKline is the manufacturer of numerous brand name prescription drugs, including but not limited to the drugs Relafen and Tagamet. SmithKline sells these and other drugs throughout the United States, including in this judicial district.

30. The defendants identified in Paragraphs 23 through 29 above are hereinafter sometimes referred to collectively as the "Manufacturer Defendants".

31. Defendant Medco Containment Services, Inc. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Montvale, New Jersey. Defendant Medco Containment, through its wholly-owned subsidiaries Defendants National Pharmacies, Inc. and PAID Prescriptions, Inc. (hereinafter collectively "Medco"), operates a mail order pharmacy that competes with Plaintiffs for the sale of brand name prescription drugs throughout the United States, including in this judicial district.

COUNT I

Plaintiffs Against the Manufacturer Defendants For Violation of Section 2(a) of the Robinson-Patman Act

32. This Count arises under Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a), and is asserted by all Plaintiffs against the Manufacturer Defendants.

33. Plaintiffs reallege and incorporate herein by reference the allegations of Paragraphs 1 through 31 of this Complaint.

Third-Party Plans

34. A substantial and growing number of consumers of prescription drugs in the United States do not themselves pay the full cost of their purchases of prescription drugs. Private employers, labor unions, and governmental entities sponsor benefit plans that cover some or all of the cost of prescription drugs for their employees, retirees, or members and families. Similarly, insurance companies and certain types of Health Maintenance Organizations ("HMOs") offer plans that cover some or all of the cost of prescription drugs for those who purchase the insurance or enroll in the HMOs. These benefit plans, insurance policies, and HMOs that cover the cost of prescription drugs are commonly referred to as "third-party plans." Millions of people nationwide have some or all of the cost of their prescription drugs covered by third-party plans.

35. The sponsors of third-party plans, alone or in conjunction with administrators that they hire to administer the plans, select the pharmacy or pharmacies that will provide so-called "maintenance drugs" to the participants in a plan. Maintenance drugs are those prescription drugs that are designed to treat chronic, long-term health problems as opposed to acute, short-term health problems. For example, drugs designed to combat ulcers, hypertension, and diabetes are maintenance drugs while those designed to combat influenza, bronchitis, and temporary pains are acute-care drugs.

36. Once the plan sponsor and/or plan administrator designates the pharmacy or pharmacies that will provide maintenance drugs under the terms of a third-party plan, the plan generally covers some or all of the cost of maintenance drug prescriptions for a plan participant only if that participant has the prescription filled by the designated provider.

37. Typically, a plan participant is issued an identification card that he or she must present to the designated provider. The designated provider fills the prescription and then receives payment from the plan sponsor or plan administrator in the amount negotiated between the provider and the plan sponsor/administrator.

38. Plaintiffs vigorously compete to be designated as maintenance-drug providers to third-party plans, i.e. to provide maintenance drugs to consumers whose purchases are covered under third-party plans.

39. Plaintiffs' competitors for these sales include, but are not limited to, other drugstore chains, independent drugstores, and "mail order pharmacies." Mail order pharmacies receive prescriptions through the mail from customers and fill those prescriptions by dispensing the drugs to customers through the mail.

Discriminatory Prices

40. Each of the Plaintiffs has purchased, in interstate commerce, maintenance drugs (including but not limited to those identified in Paragraphs 23 through 39 above) manufactured by each of the Manufacturer Defendants. The Plaintiffs purchase these drugs from the Manufacturer Defendants and/or from wholesale distributors.

41. Upon information and belief, each of the Manufacturer Defendants has sold maintenance drugs to mail order pharmacies, in interstate commerce, at substantial discounts (and/or with substantial rebates) from the price contemporaneously charged by that Manufacturer Defendant to Plaintiffs (and/or to wholesale distributors that supply drugs to Plaintiffs) for the same drugs. These discriminatory prices and/or rebates are not justified by any differing methods or quantities in which such drugs are sold.

Harm Caused By Discriminatory Prices

42. The discriminatory prices charged by the Manufacturer Defendants have caused, and continue to cause, substantial damage to Plaintiffs and to the consuming public.

43. Plaintiffs compete with mail order pharmacies for the sale of brand name, maintenance prescription drugs to consumers. As a result of the favorable, discriminatory prices charged to mail order pharmacies by the Manufacturer Defendants,

Plaintiffs have lost sales to consumers and/or have had to cut their margins in response to the unfair competitive advantage enjoyed by the mail order pharmacies.

44. Moreover, the sponsors of third-party plans select the entities that will provide maintenance drugs to plan participants based principally on price. In some instances, the plan sponsors select only a single entity to provide all of the maintenance drugs for all of the participants in a plan. As a result of the favorable, discriminatory prices charged to mail order pharmacies by the Manufacturer Defendants, those mail order pharmacies have been able to underbid Plaintiffs in the competition for selection as the sole provider of maintenance drugs to third-party plans.

45. Many third-party plans offer plan participants a choice of maintenance drug providers. For example, a particular plan may permit plan participants to have maintenance drug prescriptions filled by Plaintiffs, by other drugstores, and by a mail order pharmacy. As a result of the favorable, discriminatory prices charged to mail order pharmacies by the Manufacturer Defendants, those mail order pharmacies can and do dispense the drugs to plan participants at prices below those offered by Plaintiffs.

46. Because the sponsors of these third-party plans are sensitive to price differentials, the sponsors create financial disincentives for plan participants to choose to have

their maintenance drug prescriptions filled by Plaintiffs. Plan sponsors typically require plan participants to pay some portion of the prescription cost (called a "co-payment") and/or to satisfy a deductible if they have their prescriptions filled by Plaintiffs or other drugstores. Plan sponsors allow plan participants to make lower co-payments (or no co-payments at all) and/or waive the deductible if the prescriptions are filled by a mail order pharmacy.

47. The plan participants, like the plan sponsors themselves, are sensitive to price differentials. Therefore, the effect of these financial disincentives — which are themselves the result of the favorable, discriminatory prices charged to the mail order pharmacies by the Manufacturer Defendants — is to discourage plan participants from having their prescriptions filled by Plaintiffs. Accordingly, the Manufacturer Defendants' discriminatory prices cause Plaintiffs to lose significant sales when both a mail order pharmacy and Plaintiffs are selected as providers under a plan.

48. In other instances, the plan sponsor provides plan participants with a choice of having maintenance drug prescriptions filled by Plaintiffs or by a mail order pharmacy, but the plan sponsor reimburses the providers, whether they be drugstores or mail order pharmacies, at a single price based upon the average wholesale price of drugs. For example, a particular plan sponsor may invite numerous drugstores, as well as a mail

order pharmacy, to provide maintenance drugs under the plan, but with the proviso that the sponsor will reimburse the provider for each prescription at the rate of the average wholesale price minus a specified discount.

49. As a result of the favorable, discriminatory prices charged to mail order pharmacies by the Manufacturer Defendants, plan sponsors are able to set the reimbursement price at a level that, in many instances, is at or below Plaintiffs' cost of acquiring the drugs from the Manufacturer Defendants. Consequently, in many instances Plaintiffs are economically foreclosed from bidding to become providers of maintenance drugs to those plans. In other instances, Plaintiffs agree to provide maintenance drugs to the plan participants, but Plaintiffs lose profits on those sales because the reimbursement level set by the plan sponsor -- which is a result of the favorable, discriminatory prices charged to the mail order pharmacies by the Manufacturer Defendants -- requires Plaintiffs to cut their margins.

50. The discriminatory prices and/or rebates described above have caused and continue to cause significant harm not only to Plaintiffs, but also to the consuming public. The Manufacturer Defendants' exclusion of Plaintiffs and other drugstores from the favorable prices enjoyed by mail order pharmacies has insulated the mail order pharmacies from the

vigorous competition that they otherwise would face from Plaintiffs and others.

51. As a result of the favorable, discriminatory prices charged to mail order pharmacies by the Manufacturer Defendants, those mail order pharmacies are currently able to under-sell Plaintiffs and others on brand name prescription drugs purchased from the Manufacturer Defendants. But the retail prices charged by mail order pharmacies to consumers are higher than they would be if Plaintiffs and other drugstores were able to compete on an equal footing with the mail order pharmacies.

WHEREFORE, under this Count I Plaintiffs pray for an Order:

(a) declaring that the Manufacturer Defendants' refusal to sell brand name, maintenance prescription drugs to Plaintiffs (and/or to wholesale distributors that supply drugs to Plaintiffs) at the same price at which the Manufacturer Defendants sell the same drugs to mail order pharmacies is unlawful under Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a);

(b) permanently enjoining the Manufacturer Defendants from refusing to sell brand name, maintenance prescription drugs to Plaintiffs (and/or to wholesale distributors that supply drugs to Plaintiffs) at the same prices

at which the Manufacturer Defendants sell the same drugs to mail order pharmacies;

(c) awarding to Plaintiffs three-fold the damages sustained by them as a result of the unlawful conduct of the Manufacturer Defendants;

(d) granting to Plaintiffs the costs of suit, interest, and reasonable attorneys' fees; and

(e) granting to Plaintiffs such other and further relief as may be appropriate in the circumstances.

COUNT II

Plaintiffs Against the Manufacturer Defendants for Violation of Section 2(d) of the Robinson-Patman Act

52. This Count arises under Section 2(d) of the Robinson-Patman Act, 15 U.S.C. § 13(d), and is asserted by all Plaintiffs against the Manufacturer Defendants.

53. Plaintiffs reallege and incorporate herein by reference the allegations of Paragraphs 1 through 51 of this Complaint.

54. In addition to providing the discriminatory prices and/or rebates described in Paragraph 41 above, upon information and belief the Manufacturer Defendants permit mail order pharmacies to obtain even further discounts or rebates in

exchange for providing services to these Defendants. Specifically, in exchange for a mail order pharmacy's agreement to increase its percentage sales of the Defendant Manufacturer's brand name drug, each of these Defendants has provided, and continues to provide, special discounts and/or rebates to the mail order pharmacy. This service, by which a pharmacy actively markets a particular brand name drug that is in competition with another brand name drug that the pharmacy also sells, is referred to as a "conversion service."

55. For example, Defendant SmithKline entered into an arrangement with a mail order pharmacy, Defendant Medco, whereby Medco agreed to actively market SmithKline's ulcer drug, Tagamet, in preference to a competing ulcer drug, Glaxo's Zantac. In exchange for Medco increasing its percentage sales of Tagamet, SmithKline gave to Medco substantial further discounts and/or rebates in addition to those described in Paragraph 41 above.

56. Upon information and belief, each of the Manufacturer Defendants has permitted mail order pharmacies to provide a conversion service in exchange for additional discounts and/or rebates on the purchase of brand name, maintenance prescription drugs from that manufacturer.

57. Despite demand, the Manufacturer Defendants have failed and refused, and continue to fail and refuse, to permit Plaintiffs to provide conversion services in exchange for

discounts or rebates and/or to provide conversion services upon the same terms as those offered to mail order pharmacies.

58. The Manufacturer Defendants' failure and refusal to permit Plaintiffs to provide the conversion service, and to thereby receive discounts and/or rebates on the same terms as mail order pharmacies, has caused harm to Plaintiffs as alleged in Paragraphs 42 through 49 above, and has insulated the mail order pharmacies from vigorous competition from Plaintiffs and others as alleged in Paragraphs 50 and 51 above.

59. The discriminatory exclusion of Plaintiffs and other drugstores from the conversion service has also insulated the Manufacturer Defendants from vigorous competition among themselves. Because Plaintiffs and other drugstores do not receive discounts from the Defendant Manufacturers for providing a conversion service, Plaintiffs and other drugstores lack a full economic incentive to market any particular brand name drug in preference to its competitor.

60. Thus, by limiting access to conversion services to mail order pharmacies only, the Defendant Manufacturers have lessened competition at the supplier level as well as at the retail level. The result is that the consuming public, those who buy from mail order pharmacies as well as those who buy from drugstores, pay more for brand name, maintenance prescription drugs than they would pay if the Plaintiffs and other non-mail

order pharmacies were permitted to provide the conversion service.

WHEREFORE, under this Count II Plaintiffs pray for an Order:

(a) declaring that the Manufacturer Defendants' refusal to provide discounts and/or rebates to Plaintiffs in exchange for conversion services with respect to brand name, maintenance prescription drugs, on the same terms on which the Manufacturer Defendants provide those discounts and/or rebates to mail order pharmacies, is unlawful under Section 2(d) of the Robinson-Patman Act, 15 U.S.C. § 13(d);

(b) permanently enjoining the Manufacturer Defendants from refusing to provide discounts and/or rebates to Plaintiffs in exchange for conversion services with respect to brand name, maintenance prescription drugs, on the same terms on which the Manufacturer Defendants provide those discounts and/or rebates to mail order pharmacies;

(c) awarding to Plaintiffs three-fold the damages sustained by them as a result of the unlawful conduct of the Manufacturer Defendants;

(d) granting to Plaintiffs the costs of suit, interest, and reasonable attorneys' fees; and

(e) granting to Plaintiffs such other and further relief as may be appropriate in the circumstances.

COUNT III

Plaintiffs Against
Defendant Medco

61. This Count arises under Section 2(f) of the Robinson-Patman Act, 15 U.S.C. § 13(f), and is asserted by all Plaintiffs against Defendant Medco.

62. Plaintiffs reallege and incorporate herein by reference the allegations of Paragraphs 1 through 60 of this Complaint.

63. Defendant Medco competes with Plaintiffs in interstate commerce for sales of brand name, maintenance prescription drugs in the manner alleged in Paragraphs 43 through 49 above.

64. Upon information and belief, Defendant Medco has knowingly induced and/or received from manufacturers of brand name, maintenance prescription drugs discriminatory prices and/or rebates which are prohibited by Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a).

65. Specifically, Defendant Medco has knowingly induced and/or received from numerous manufacturers, including the Manufacturer Defendants, maintenance drugs at substantial discounts (and/or with substantial rebates) from the prices charged by those same manufacturers to Plaintiffs (and/or to

wholesale distributors that supply drugs to Plaintiffs) for the same drugs. These discriminatory prices and/or rebates are not justified by any differing methods or quantities in which such drugs are sold.

66. Defendant Medco's unlawful conduct has caused, and continues to cause, harm to Plaintiffs in the manner alleged in Paragraphs 42 through 49 above.

WHEREFORE, under this Count III Plaintiffs pray for an Order:

(a) declaring that Defendant Medco's practice of inducing and/or receiving from manufacturers prices for brand name, maintenance prescription drugs below those at which those manufacturers sell the same drugs to Plaintiffs (and/or to wholesale distributors that supply drugs to Plaintiffs) is unlawful under Section 2(f) of the Robinson-Patman Act, 15 U.S.C. § 13(f);

(b) permanently enjoining Defendant Medco from inducing and/or receiving from manufacturers prices for brand name, maintenance prescription drugs below those at which those manufacturers sell the same drugs to Plaintiffs (and/or to wholesale distributors that supply drugs to Plaintiffs);

(c) awarding to Plaintiffs three-fold the damages sustained by them as a result of the unlawful conduct of Defendant Medco;

(d) granting to Plaintiffs the costs of suit, interest, and reasonable attorneys' fees; and

(e) granting to Plaintiffs such other and further relief as may be appropriate in the circumstances.

COUNT IV

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Plaintiffs Against the Manufacturer Defendants for Violation of Section 1 of the Sherman Antitrust Act

67. This Count arises under Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, and is asserted by all Plaintiffs against the Manufacturer Defendants.

68. Plaintiffs reallege and incorporate herein by reference the allegations of Paragraph 1 through 66 of this Complaint.

69. HMOs provide prescription drugs to their subscribers pursuant to one of the following two basic methods:

(a) The Independent Practice Association Model HMO functions in essentially the same manner as a third-party plan, with the HMO contracting with various providers to provide both acute-care and maintenance drugs to the subscribers.

(b) The Staff Model HMO owns and operates its own pharmacy from which it dispenses prescription drugs directly to the HMO subscribers. The subscribers must go to the designated

site of the HMO to obtain all medical services, including the filling of prescriptions.

70. Staff Model HMOs purchase brand name prescription drugs manufactured by the Manufacturer Defendants from wholesale distributors.

71. Similarly, hospitals and nursing homes also purchase brand name prescription drugs manufactured by the Manufacturer Defendants from wholesale distributors.

72. Staff Model HMOs, hospitals, and nursing homes that purchase brand name prescription drugs from the Manufacturer Defendants are hereinafter collectively referred to as "Favored Purchasers."

Vertical Combinations

73. Upon information and belief, each of the Manufacturer Defendants has entered into agreements with wholesale distributors concerning the price at which those distributors will sell that manufacturer's brand name drugs to Favored Purchasers.

74. Pursuant to this arrangement, each of the Manufacturer Defendants has agreed with Favored Purchasers as to the price at which the Favored Purchaser will be permitted to purchase that Defendant's brand name drugs from a wholesale distributor. These agreements provide that the Favored

Purchasers may purchase the Defendant's brand name drugs at substantial discounts, in many instances as much as 50 percent below the price at which the Defendant sells the same brand name drugs to Plaintiffs.

75. Pursuant to agreements referred to as "charge-back agreements," the wholesale distributors have agreed with each of these Defendants to charge to the Favored Purchasers the discounted prices negotiated between these Defendants and the Favored Purchasers.

76. When the Favored Purchasers purchase the drugs from the wholesale distributers (at the prices agreed to by the Manufacturer Defendants), the wholesale distributors fill the orders from their own inventory of goods to which they have previously taken title from the Manufacturer Defendants.

77. Pursuant to the charge-back agreement, the wholesale distributor "charges-back" or invoices the Manufacturer Defendant for the difference between the amount that the distributor paid the Manufacturer Defendant for the drugs and the discounted amount (negotiated between the Manufacturer Defendant and the Favored Purchaser) at which the distributor sold the drugs to the Favored Purchaser, plus a fee. The Manufacturer Defendant then pays or credits that amount to the distributor.

78. The Manufacturer Defendants have economically coerced the wholesale distributors into participating in the

charge-back arrangements. Because the prices negotiated between the Manufacturer Defendants and the Favored Purchasers are below the distributors' costs of acquiring the drugs from the Manufacturer Defendants, the distributors are economically foreclosed from selling the drugs to the Favored Purchasers except through the charge-back arrangements.

79. Upon information and belief, each of the Manufacturer Defendants has entered into such charge-back agreements with wholesale distributors as to sales of brand name, prescription drugs to Favored Purchasers.

80. The charge-back agreements are in unreasonable restraint of trade.

Horizontal Combinations

81. Upon information and belief, the Manufacturer Defendants have acted in concert in failing to extend to Plaintiffs the discounted prices that they have extended to the Favored Purchasers through the mechanism of the charge-back agreements.

82. Upon information and belief, the Manufacturer Defendants have also acted in concert in precluding wholesale distributors from engaging in arbitrage, i.e., from using the rebates or credits received from sales to Favored Purchasers to lower the prices at which they sell the same drugs to Plaintiffs and other non-favored purchasers. Because the wholesale

distributors are entitled under the charge-back agreements to receive refunds or credits only for sales to the Favored Purchasers and only in an amount necessary to make the distributors "whole," the charge-back agreements necessarily prevent the wholesale distributors from using the refunds or credits received from the Manufacturer Defendants to lower the prices at which the distributors sell the same drugs to Plaintiffs and to other non-favored purchasers.

83. The actions of the Manufacturer Defendants are in unreasonable restraint of trade.

Harm Caused to Plaintiffs

84. The charge-back agreements between the Manufacturer Defendants and the wholesale distributors have resulted in Favored Purchasers paying artificially low prices for their purchases of brand name, prescription drugs manufactured by these Defendants.

85. Because the discounts enjoyed by the Favored Purchasers are charged-back by the distributors to the Manufacturer Defendants, those Defendants have sought to maintain their overall profit margins by charging correspondingly artificially high prices for the same drugs sold to disfavored purchasers, such as independant drugstores and chain drugstores, including Plaintiffs.

86. The result of the joint and several conduct of the Manufacturer Defendants in entering into charge-back agreements with wholesale distributors has been to cause Plaintiffs to pay artificially high prices for drugs manufactured by the Manufacturer Defendants.

WHEREFORE, under this Count IV Plaintiffs pray for an Order:

(a) declaring that the charge-back agreements entered into between the Manufacturer Defendants and wholesale distributors as to sales of prescription drugs to Staff Model HMOs, hospitals, and nursing homes are unlawful under Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1;

(b) permanently enjoining the Manufacturer Defendants from continuing such charge-back agreements or entering into such agreements in the future;

(c) declaring that the concerted action between and among the Manufacturer Defendants in failing to extend to Plaintiffs the discounted prices that those Defendants have extended to Staff Model HMOs, hospitals, and nursing homes is unlawful under Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1;

(d) declaring that the concerted action between and among the Manufacturer Defendants in precluding wholesale

distributors from engaging in arbitrage is unlawful under Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1;

(e) permanently enjoining the Manufacturer Defendants from continuing such concerted action and from engaging in such concerted action in the future;

(f) awarding to Plaintiffs three-fold the damages sustained by them as a result of the unlawful conduct of the Manufacturer Defendants;

(g) granting to Plaintiffs the costs of suit, interest, and reasonable attorneys' fees; and

(h) granting to Plaintiffs such other and further relief as may be appropriate in the circumstances.

COUNT V

Plaintiffs Against the Manufacturer Defendants For Violation of Section 2(a) of the Robinson-Patman Act

87. This Count arises under Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a), and is asserted by all Plaintiffs against the Manufacturer Defendants.

88. Plaintiffs reallege and incorporate herein by reference the allegations of Paragraphs 1 through 86 of this Complaint.

89. Through the mechanism of the charge-back agreements, the Manufacturer Defendants have arranged for Staff Model HMOs -- both for-profit and not-for-profit Staff Model HMOs -- to purchase the Manufacturer Defendants' brand name prescription drugs at prices that are significantly discounted from the prices at which the Manufacturer Defendants sell the same drugs to Plaintiffs (and/or to wholesale distributors that supply drugs to Plaintiffs). The prices at which the Staff Model HMOs purchase the drugs are set by the Manufacturer Defendants, not by the wholesale distributers.

90. The favorable, discriminatory prices made available, directly or indirectly, by the Manufacturer Defendants to Staff Model HMOs are not justified by any differing methods or quantities in which such drugs are sold.

91. Plaintiffs compete with Staff Model HMOs for sales of brand name, prescription drugs to consumers.

92. Plaintiffs have lost, and continue to lose, sales to consumers as a result of the joint and several conduct of the Manufacturer Defendants in charging discriminatorily favorable prices to Staff Model HMOs.

WHEREFORE, under this Count V Plaintiffs pray for an Order:

(a) declaring that the Manufacturer Defendants' refusal to sell brand name prescription drugs to Plaintiffs

(and/or to wholesale distributors that supply drugs to Plaintiffs) at the same price at which the Manufacturer Defendants make the same drugs available to Staff Model HMOs is unlawful under Section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a);

(b) permanently enjoining the Manufacturer Defendants from refusing to sell brand name prescription drugs to Plaintiffs (and/or to wholesale distributors that supply drugs to Plaintiffs) at the same prices at which the Manufacturer Defendants make the same drugs available to Staff Model HMOs;

(c) awarding to Plaintiffs three-fold the damages sustained by them as a result of the unlawful conduct of the Manufacturer Defendants;

(d) granting to Plaintiffs the costs of suit, interest, and reasonable attorneys' fees; and

(e) granting to Plaintiffs such other and further relief as may be appropriate in the circumstances.

COUNT VI

Plaintiffs Against All Defendants For Unfair Competition

93. This Count arises under the common law and is asserted by all Plaintiffs against all Defendants.

94. Plaintiffs reallege and incorporate herein by reference the allegations of Paragraphs 1 through 92 of this Complaint.

95. By the acts alleged in Paragraphs 1 through 92 above, Defendants have engaged, and are continuing to engage, in individual and concerted courses of conduct, the purpose and effect of which have been, and are, to put Plaintiffs at a significant and unfair competitive disadvantage.

96. As a result of the Defendants' conduct, Plaintiffs have sustained, and continue to sustain, significant damage.

97. The conduct of the Defendants has been, and is, willful, wanton, and in reckless disregard of the rights of Plaintiffs.

WHEREFORE, under this Count VI Plaintiffs pray for an Order:

(a) declaring that Defendants have violated the common law;

(b) permanently enjoining the unlawful conduct of the Defendants;

(c) awarding to Plaintiffs the damages sustained by them as a result of the unlawful conduct of the Defendants;

(d) awarding to Plaintiffs exemplary damages;

(e) granting to Plaintiffs the costs of suit, interest, and reasonable attorneys' fees; and

(f) granting to Plaintiffs such other and further relief as may be appropriate in the circumstances.

JURY DEMAND

98. Plaintiffs demand trial by jury on all claims for which there is a right to a jury trial.

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

BACON-NORMANDI CORPORATION, D/B/A LAWSON-DYER PHARMACY, a California corporation, on behalf of itself and all others similarly situated, Plaintiff, vs. MEDCO CONTAINMENT SERVICES, INC.; MCKESSON CORPORATION, BERGEN BRUNSWIG DRUG COMPANY, INC.; BRISTOL-MYERS-SQUIBB; FOREST PHARMACEUTICAL, INC.; RHONE-POULENC RORER; SCHERING-PLOUGH; Defendants.	CASE NO. CLASS ACTION COMPLAINT FOR: (1) VIOLATIONS OF THE ROBINSON-PATMAN ACT (2) VIOLATIONS OF SECTION 2(a), CLAYTON ACT (15 U.S.C. §13(a)) (3) PRICE DISCRIMINATION (JURY TRIAL DEMANDED)

Plaintiff, on behalf of himself and all others similarly situated, bring these proceedings under the provisions of Section 4 of the Clayton Act (15 U.S.C.A. 15) for violations of 2(a) of the Clayton Act (15 U.S.C.A. § 13(a)), the Robinson-Patman Act to secure damages (15 U.S.C. §15) and injunctive relief (15 U.S.C. §26) for defendants' practices, carried on jointly and separately, of discriminating in price between plaintiff and plaintiff's competitors who sell pharmaceuticals to patients or retail customers in the same markets.

I.

DESCRIPTION OF THE PARTIES

1. Plaintiff Bacon-Normandi Corporation (hereinafter "Plaintiff"), a California corporation, is a retail pharmacy distributing prescription pharmaceuticals in Mill Valley, California under the name of Lawson-Dyer Pharmacy. Steven Bacon, his father and mother have operated the pharmacy for over 50 years and have continuously operated that business to the present. Plaintiff is no vagrant class representative. For 30 years the family have been active officials of various associations of community retail pharmacists which have been struggling, lobbying and litigating to correct or ameliorate the offenses hereinafter alleged.

2. Medco Containment Services, Inc. ("Medco") of Montvale, New Jersey, is a Delaware corporation and is hereby made a defendant herein. Medco designs and manages prescription drug benefit plans allegedly to control plan sponsors' costs. Through its mail-service pharmacies the company delivers prescription drugs nationwide to the homes of sponsors' plan participants and the general market of retail customers at a lower cost than is generally available through retail pharmacies although its prices remain high and non-competitive by reason of the offenses hereinafter alleged. As of September 1, 1992 Medco provided mail-service prescription drug programs through 112 pharmacies in nine states. Within the past two weeks Merck & Company, the world's largest drug company, announced that it will acquire Medco for $6 billion. The acquisition in the context of the facts alleged in this complaint violates the Federal Antitrust Laws, Section 7 of the Clayton Act and Section 1 of the Sherman Act. (15 U.S.C. §18; 15 U.S.C. §1) Medco's 1992 sales were $1.81 billion; its net profits $102.53 million. Merck's 1992 sales were $9.65 billion; its net profits, $2.45 billion. From 1988 to 1992 Medco's sales increased from $600 million to $1.81 billion. In the same period Merck's sales soared from $6 billion to $9.66 billion.

3. Bergen Brunswig Drug Company, Inc. ("Bergen") is hereby made a defendant herein. Bergen is a wholesaler of

pharmaceuticals and other drug store items. It has a regional office in San Jose, California and transacts business on a regular basis throughout California and the United States. Approximately 42% of its pharmaceutical business is with community pharmacists such as plaintiff and the members of the proposed class.

4. Bristol-Myers-Squibb ("Bristol-Myers"), a Delaware corporation, is hereby made a defendant herein. Bristol-Myers is the world's second largest pharmaceuticals concern, with important drugs in key cardiovascular, anti-infective, anticancer and other areas. It also has significant sales in infant nutritionals, over-the-counter medications, medical devices and toiletries. Net sales for fiscal year ending 1992 were $11.15 billion.

5. Rhone-Poulenc Rorer ("Rorer") of Collegeville, Pennsylvania is hereby made a defendant herein. Rorer produces a wide range of prescription and over-the-counter drugs, and operates in all major world pharmaceutical markets, including in the interstate commerce of the United States. Rorer's net sales for 1992 were $4.1 billion. Rorer sells to retailers, hospitals, HMOs and mail order houses in the United States on a regular basis through wholesale drug companies and directly.

6. Schering-Plough ("Schering") of Madison, New Jersey is hereby made a defendant herein. Schering is a leading international manufacturer of prescription and over-the-counter drugs. Schering sells in interstate commerce to retailers, hospitals, HMOs and mail order houses in the United States on a regular basis through wholesale drug companies and directly.

7. Forest Pharmaceuticals, Inc. ("Forest"), a subsidiary of Forest Laboratories, Inc. of St. Louis, Missouri, is hereby made a defendant herein. Forest is a leading international manufacturer of prescription drugs. Forest sells in interstate commerce to retailers, hospital, HMOs and mail order houses in the United States on a regular basis through wholesale drug companies and directly.

8. McKesson Corporation ("McKesson") of San Francisco, California is hereby made a defendant herein. McKesson is a wholesaler in interstate commerce of pharmaceuticals and other drug store items. It distributes pharmaceuticals throughout the United States to community pharmacists such as plaintiff and members of the proposed class.

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II.

CLASS ACTION ALLEGATIONS

9. Plaintiff brings the claims alleged herein as a class action pursuant to Rule 23b(2) and 23b(3) of the Federal Rules of Civil Procedure on behalf of himself and all others similarly situated. The Class entities consist of:

> Community retail pharmacists throughout the United States (including pharmacists who maintain mini-chains of stores with ten locations or less) who have purchased any prescription pharmaceutical over the past four years.

10. This action is properly maintainable as a class action for the following reasons:

(a) On information and belief, the class consists of over 38,000 entities and hence is so numerous that joinder of all class members is impracticable.

(b) There are questions of law and fact common to the members of the class and there is a need for a uniform remedy regarding the matters alleged herein.

(c) The claims of the plaintiff are typical of the claims of the members of the proposed class, and the plaintiff will fairly and adequately represent and protect the interests of

the proposed class. Plaintiff has been and remains a long-time activist in the trade associations which have sought to correct or ameliorate the offenses hereinafter alleged. The plaintiff has no interests antagonistic to those of the remainder of the class. The plaintiff's attorneys are qualified, experienced and able to conduct the proposed litigation.

(d) The questions of law and fact common to members of the proposed class predominate over any questions affecting only individual members.

(e) A class action is superior to other methods for the fair and efficient adjudication of the claims here asserted, and no unusual difficulties are likely to be encountered in the management of this class action. The likelihood of many of the individual class members prosecuting separate claims is remote.

(f) Defendants have acted or refused to act on grounds generally applicable to all members of the proposed class, thereby making injunctive relief wit espect to the class as a whole an effective remedy.

(g) The prosecution of separate actions by individual class members would create a risk of inconsistent or varying adjudications and might b lispositive of the interests of other class members who are not parties to those adjudications

or may substantially impair or impede their ability to protect their interests.

III.

RELEVANT OPERATIVE FACTS

11. There are approximately 60,000 community pharmacies in the United States, employing more than 112,000 community pharmacists, who dispense over 2 billion subscriptions per year.

12. It is essential to the preservation of a competitive community pharmacy marketplace that widespread price discrimination by manufacturers of prescription drugs be eliminated because the favored buyers compete with community pharmacists for the same group of customers.

13. A graphic example of the spread between the independent pharmacy acquisition costs and the mail order acquisition costs as disclosed in 1992 from McKesson-Robbins invoices is as follows:

Product	Ind. Pharmacy Acquisition Cost	Supplier	Mail Order Acquisition Cost
Aerobid Inhaler System, 7 gm	$33.61	Forest Lab	$2.58
Albuterol Sol., 3 ml U/D, 25	25.70	Schering	12.81

Levothroid Tab., 300 mcg, 100	28.02	Rorer	9.79
M.T.E. 5 Conc. 10ml, 10	192.32	Lyphomoll	21.68
Proventil Inhaler Ref., 17 gm	17.47	Schering	12.54
Proventil Inhaler Ref., 17 gm	16.10	Schering	11.56
Theo-Dur SA Tab., 300 mg, 500	106.55	Key	58.28
Theo-Dur Sprink Cap. 200 mg, 100	17.91	Key	9.80
Thyroid Tab., 3 gr, 1000	200.43	Rorer	20.09
Thomalate+ Nebulizer, 15 ml	22.86		2.63
Bancap HC Cap, 500	254.80	Forest	18.59

14. The 50 drugs most frequently used in office practice in the United States are listed in Exhibit A attached hereto. Virtually all of these most frequently used drugs have been sold under the discriminatory prices hereinafter alleged.

15. Published prices for prescription drugs in the United States do not reflect discounts and rebates. A study in 1992 (attached hereto as Exhibit B) reflects the wide variance in discounts off list prices.

16. The market share of pharmaceutical sales in the United States by trade channel is approximately as follows:

TRADE CHANNEL	Percentage	Dollars (Billions)
Community Pharmacies	61.2	$30.2
Hospitals	23.0	11.4
Mail Order Companies	5.9	2.9
HMOs (staff model)	2.4	1.2
Other	7.6	3.78
	100.10	49.48

17. Branded pharmaceutical prices in the United States showed a constant artificial upward trend in the past decade while generic product, sold by many independent manufacturers, which are therapeutically interchangeable, showed a downward trend. Price competition among equivalent generics is intense as against the limited competition among branded pharmaceuticals. This limited competition is the result, in part, of defendants' illegal acts charged herein including their maintenance of wide discrepancies in prices charged plaintiff and its competitors which are not justified by costs or value-added function nor the meeting of competition.

18. A study comparing 1987 and 1992 discounting across pharmaceutical distribution channels is appended hereto as Exhibit C. It discloses what defendants know; namely, that the discriminatory discount-rebate activity in the distribution channels for brand-name pharmaceuticals has increased

significantly in recent years. Not only the level of discounting but also that portion of the market receiving deeper discounts - to plaintiff's prejudice - has increased substantially.

IV.

OFFENSES

19. Beginning at least in 1983 and continuing up to date, the manufacturing defendants, the wholesaler defendants and the mail order defendant, separately and in conspiracy with each other, engaged in massive schemes of price discrimination, secret rebates and kick-backs involving favored and disfavored competing for-profit retailers in the interstate sale of prescription pharmaceuticals, which price differences were not cost-justified or functionally-justified and which had the intended effect of substantially restraining and lessening competition and tending to create monopoly in the interstate sale of prescription drugs and of raising their price to the consumers to high and artificial levels, all in violation of Section 2(a) of the Clayton Act (15 U.S.C. § 13(a)).

20. The aforesaid schemes and conspiracy consisted of a concert of action between individual wholesalers and manufacturers to grant price differences of 30% to 50% and in

some sales up to 90% off list prices to favored buyers such as the defendant Medco.

21. The means and methods used by defendants to implement the aforesaid schemes and conspiracy included, inter alia, the following:

(a) Manufacturers granted large and substantial unjustifiable price discriminations to plaintiff's for-profit competitors who were mail order houses, hospitals, HMOs and various types of clinics which sold prescription drugs to the same groups of patients and customers for whose favor plaintiff and all other community pharmacists competed;

(b) In some cases the wholesaler gave the customer a secret discount on the ingredient component of the sale price, and in turn was given a secret rebate by the manufacturer equal to the discount;

(c) In other cases the wholesaler billed at one price and thereafter the manufacturer would make a secret rebate to the favored customer directly with the knowledge and connivance of the wholesaler; and

(d) Independently and cumulatively of the foregoing, the wholesaler would give its favored customer a discount,

rebate or kick-back in respect to the non-ingredient component of the sale;

(e) Discounts, rebates, charge-backs and kick-backs in the millions of dollars were involved therein and kept secret from the trade.

22. The defendants did those things which they schemed - and conspired to do, and granted massive price discriminations to plaintiff's competitors which by their own admissions could not be justified by cost saving, economies of scale or true functional differences, and many of plaintiff's customers stopped dealing with plaintiff and other community pharmacists by reason thereof.

23. In addition to the extraordinary price differences charged to plaintiff as against plaintiff's competitors; the defendants collaborated in granting substantial but lesser price discriminations to plaintiff's chain store competitors using the same schemes and conspiracies and the elements thereof, as previously alleged.

24. Each of the defendant manufacturers was cognizant of the fact that the inevitable and intended result of their rampant price discriminations was to create among virtually all manufacturers a two-price system with community pharmacists

subsidizing the extraordinary low prices of the favored buyer by the extraordinary high prices they paid. By at least tacit understanding among all of the defendant manufacturers, with the collaboration of the wholesalers, the two price system compelling community pharmacists to pay the higher prices was deliberately and consciously maintained. This concert of action among the manufacturers to maintain so disparate a spread between community pharmacist prices and, e.g., Medco's prices, stratifies high price levels to the consumer, as intended by defendants.

25. The proposed acquisition by Merck of Medco for $6 billion creates a trust in violation of Section 7 of the Clayton Act (15 U.S.C. §18) and the contract to acquire Medco is a contract in restraint of trade which violates Section 1 of the Sherman Act (15 U.S.C. §1)

26. In many instances the prices charged to favored customers such as Medco were below cost, but they were subsidized by the unreasonably higher prices charged to community pharmacies, such as plaintiff, which constitute about 60% of the market.

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IV.

EFFECTS OF THE OFFENSES

27. The clearly foreseeable and therefore intentional effects of the offenses heretofore stated include, inter alia, the following:

(a) independent community pharmacies, including plaintiff, have been subjected to a price squeeze between their costs and the competitive sales prices they charged, causing many of them to lose customers or go bankrupt or sell their stores to defendants' favored customers at distress prices;

(b) Independent community pharmacies, including plaintiff, suffered loss of customers to favored buyers and have lost substantial profits that otherwise would have been made in a market free of defendants massive price discriminations;

(c) Prices to customers for prescription drugs have been raised to high and artificial levels because the favored customers, such as Medco, did not pass on the lower costs to customers but priced their products just under the umbrella of the higher prices necessarily charged by community pharmacists because of the discriminatory prices they paid to wholesalers and manufacturers;

(d) The plaintiff's business was damaged, his customers were diverted, his profits were diminished and the resale value of his store was substantially lessened by reason of the violations herein alleged, which were the proximate cause of plaintiff's injury. Due to those violations, plaintiff is in immediate danger of losing his business, which he has continuously maintained for 30 years. Community pharmacists throughout the country have similarly suffered.

28. The pharmaceutical manufacturers, wholesalers and favored retailers are well aware of these effects, and in particular each has knowledge that the substantial lower prices of the favored customers, such as Medco, are not being passed on to consumers. Instead, the higher prices which manufacturers force community pharmacists to pay act as an umbrella under which the favored buyers can raise their prices to levels just below the community pharmacists; thus earning extraordinary profits while they injure the disfavored buyers. Medco's CEO, e.g., received compensation in 1992 of approximately $30,000,000. In addition he is slated to receive $60,000,000 for making the Merck deal. These amounts constitute monopoly profits directly derived from the offenses herein alleged.

29. The spread between Medco's cost and Medco's price is so great that Medco is enabled to sell and does sell some of

its pharmaceuticals to other corporations and to some wholesalers at lower prices than the wholesalers can get from the manufacturer when community pharmacists are the wholesaler's buyers.

30. The entire pricing systems of manufacturers, wholesalers and favored buyers create a web of artificial, distorted and unnatural market conditions driven by the enormous spread between prices for favored buyers and prices for disfavored buyers for identical pharmaceuticals. Two effects have resulted: consumers suffer high and artificial price levels, and the business of community pharmacists is damaged or destroyed by diversion of their customers to the favored buyer. But for the distortions created by price discriminations, the market in prescription drugs for consumers would be closer to a weighted average of acquisition costs by all buyers with due allowance for cost-justified differences, plus a competitive mark-up for gross profit margins, a level of prices substantially below the artificial market caused by the offenses herein stated.

31. The ultimate effects of the price discriminations; alleged herein include the following:

(a) Consumer prices for prescription drugs are at high, non-competitive levels forcing many of the elderly, the

uninsured and the poor to go without prescription drugs or to limit their use to dangerous levels;

(b) Community drugstores are being forced out of business at an alarming rate, though they serve a unique function in the delivery of prescription drugs on a personal basis through long relationships with the elderly and the sick;

(c) The favored buyers and the drug manufacturers are realizing monopoly profits because of the offenses herein stated. A nondiscriminatory price in a competitive market place would force down the price of prescription drugs to at least a weighted average of the legal acquisition cost of all buyers plus a competitive mark-up.

32. The plaintiff and the proposed class have been damaged as a proximate cause of the offenses alleged in this complaint and they are in danger of losing their business. Many independent community pharmacists have been similarly damaged and some have been forced out of business by reason of the price discriminations herein alleged. Unless these price discriminations are effectively enjoined, the community pharmacists including plaintiff, and the marketplace in pharmaceuticals, will suffer irreparable damage.

33. Plaintiff and community pharmacists throughout the United States have been damaged in both lost revenues and in the diminution of the value of their businesses as a going concern.

PRAYER FOR RELIEF

WHEREFORE, PLAINTIFF PRAYS AS FOLLOWS:

1. That, pursuant to Rule 23 of the Federal Rules of Civil Procedure, a class be certified as defined in paragraph 9 herein.

2. That the price discriminations alleged herein be adjudged to be illegal, and that a preliminary and permanent injunction be issued to enjoin any price differences between plaintiff and his competitors and between said class and their competitors unless justified by economies of scale, volume or value-added function as provided in Section 2(a)(d) and (e) of the Clayton Act.

3. That plaintiff receive for his damages the sum to be determined at trial according to the proof trebled as required by law.

4. That judgment for actual damages be entered for said class in an amount to be determined according to the proof, and that said amount be trebled as required by law.

5. That plaintiff receive an award for an attorneys' fee and costs of litigation as provided by law; and

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6. That the Court order such other and further relief as shall be just and equitable.

DATED: August 11, 1993

Respectfully submitted,

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June 1, 1993 EXHIBIT A -

Table 1. The 50 drugs most frequently utilized in office practice by entry name, number and percent of mentions, rank, and therapeutic use: United States, 1990

Rank	Entry name of drug and principal generic substance (1)	Number of mentions (000)	%	Therapeutic use
	All drugs	759,406	100	All therapeutic uses
1	Amoxicillin	17,881	2.38	Antibiotic
2	Amoxil (amoxicillin)	13,448	1.77	Antibiotic
3	Ceclor (cefaclor)	8,910	1.17	Antibiotic
4	Lasix (furosemide)	8,888	1.17	Diuretic, antihypertensive
5	Prednisone	7,830	1.03	Steroid replacement therapy, anti-inflammatory agent
6	Naprosyn (naproxen)	7,585	1.00	Nonsteroidal anti-inflammatory agent
7	Seldane (terfenadine)	7,281	0.95	Antihistaminic
8	Motrin (ibuprofen)	6,988	0.92	Nonsteroidal anti-inflammatory agent
9	Zantac (ranitidine)	6,501	0.86	Duodenal or gastric ulcer
10	Premarin (estrogens)	6,327	0.83	Estrogen replacement therapy
11	Lanoxin (digoxin)	6,275	0.83	Cardiotonic/digitalis
12	Vasotec (enalapril)	5,981	0.79	Antihypertensive
13	Aspirin or A.S.A.	5,896	0.78	Analgesic, anti-inflammatory, antipyretic
14	Proventil (albuterol)	5,614	0.74	Bronchodilator
15	Dyazide (triamterene, hydrochlorthiazide)	5,584	0.74	Diuretic, antihypertensive
16	Diphtheria tetanus toxoids pertussis	5,178	0.68	Immunization
17	Voltaren (diclofenac sodium)	5,160	0.68	Nonsteroidal anti-inflammatory agent
18	Tylenol (acetaminophen)	5,144	0.68	Analgesic
19	Synthroid (levothyroxine)	5,137	0.68	Thyroid hormone therapy
20	Xanax (alprazolam)	5,089	0.67	Anxiety disorders
21	Cardizem (diltiazem)	4,979	0.66	Cardiotonic/calcium channel blocking agent
22	Capoten (captopril)	4,788	0.63	Antihypertensive
23	Prozac (fluoxetine)	4,765	0.63	Antidepressant
24	Calan (verapamil)	4,756	0.63	Cardiotonic/calcium channel blocking agent
25	Ventolin (albuterol)	4,658	0.61	Bronchodilator
26	Theo-dur (theophylline)	4,600	0.61	Bronchodilator
27	Poliomyelitis vaccine	4,551	0.60	Immunization
28	Tavist (clemastine)	4,405	0.58	Antihistaminic
29	Keflex (cephalexin)	4,285	0.56	Antibiotic
30	Tenormin (atenolol)	4,231	0.56	Antihypertensive, angina pectoris
31	Vancenase (beclomethasone dipropionate)	4,108	0.54	Intranasal steroid
32	Inderal (propranolol)	3,970	0.52	Hypertension, angina pectoris, arrhythmia, migraine
33	Timoptic (timolol)	3,877	0.51	Glaucoma
34	Cipro (ciprofloxacin)	3,823	0.50	Antibiotic
35	Augmentin (amoxicillin, potassium clavulanate)	3,783	0.50	Antibiotic
36	Entex (phenylpropanolamine, phenylephrine, guaifenesin)	3,757	0.49	Cough preparation
37	Tylenol No. 3 (acetaminophen, codeine)	3,729	0.49	Analgesic
38	Procardia (nifedipine)	3,698	0.49	Cardiotonic/calcium channel blocking agent
39	Darvocet-N (propoxyphene, acetaminophen)	3,653	0.48	Analgesic
40	Duricef (cefadroxil)	3,573	0.47	Antibiotic
41	Micronase (glyburide)	3,434	0.45	Hypoglycemic
42	Tetracycline	3,382	0.45	Antibiotic
43	Ampicillin	3,310	0.44	Antibiotic
44	Erythromycin	3,290	0.43	Antibiotic
45	Coumadin (warfarin)	3,183	0.42	Anticoagulant
46	E.E.S. (erythromycin)	3,172	0.42	Antibiotic
47	Valium (diazepam)	3,168	0.42	Anxiety disorders
48	Benadryl (diphenhydramine)	3,150	0.41	Antihistaminic
49	Ortho-novum (norethindrone, estradiol or mestranol)	3,041	0.40	Oral contraceptive
50	Tagamet (cimetidine)	3,014	0.40	Duodenal or gastric ulcer

(1)The trade or generic name used by the physician on the prescription or other medical records.
Note: Because of its non-specific nature, the entry "Allergy relief or shots," with 4,184,000 mentions, is omitted.
*The term utilization is defined as the prescribing or providing of a new or continued drug in the course of an office visit. It is not an indication of patient compliance.
**Table courtesy of National Center for Health Statistics.

EXHIBIT B

Top 100 Largest Discriminatory Prices for PruCare September 1991 Contract Table 1

Product	AWP	Contract Price	% Off AWP
Choephyllin elixir, pint	$42.13	$1.80	$95.73%
Isordil 20 mg tabs, 500	159.03	8.50	94.65%
Bactrim tabs, 100	61.95	4.02	93.51%
Inderal 20 mg tabs, 100	35.10	2.39	93.19%
Inderal 20 mg tabs, 1000	337.49	22.94	93.47%
Inderal 10 mg tabs, 1000	239.60	15.67	93.47%
Isordil 10 mg tabs, 100	21.76	1.43	93.43%
Bleph-10 Ophth. Soln., 15 ml	14.44	0.95	93.42%
Inderal 40 mg tabs, 1000	427.99	28.03	93.42%
Inderal 10 mg tabs, 100	24.56	1.63	93.36%
Inderal 60 mg tabs, 100	61.80	4.12	93.34%
Isordil 20 mg tabs, 100	33.63	2.25	93.31%
Inderal 40 mg tabs, 100	44.74	3.02	93.23%
Isordil 30 mg tabs, 500	179.60	12.43	93.08%
Bactrim DS tabs, 500	410.01	28.50	93.05%
Aerobid Inhaler, 7 gm	35.16	2.50	92.89%
Uniphyl 400 mg tabs, 100	48.43	3.45	92.88%
Inderal 80 mg tabs, 100	68.60	5.01	92.70%
Isordil 10 mg tabs, 1000	204.59	15.50	92.42%
Dynapen 500 mg caps, 50	87.77	6.76	92.30%
Isordil 10 mg tabs, 500	103.41	8.00	92.26%
Dynapen 250 mg caps, 100	93.95	7.50	92.02%
Isordil 5 mg tabs, 100	18.65	1.53	91.80%
Isordil 5 mg SL tabs, 100	18.56	1.53	91.76%
Chloroptic Ophth. Oint., 3.5 gm	11.35	0.95	91.63%
Albalon Liquifilm, 15 ml	11.31	0.95	91.60%
Isordil 2.5 mg SL tabs, 100	17.38	1.50	91.37%
Calan 80 mg tabs, 100	39.54	3.50	91.15%
Calan 80 mg tabs, 500	189.71	16.80	91.14%
Isordil 30 mg tabs, 100	37.84	3.40	91.01%
Erygel 2% Topical Gel, 30 gm	15.75	1.44	90.86%
Bleph-10 SOP, 3.5 gm	10.80	1.08	90.01%
Ophthetic Ophth. Drops, 15 ml	10.31	0.95	90.79%
Ergot tabs, 100	48.78	4.50	90.68%
Bacitracin Ophth. Oint., 3.5 gm	13.19	1.26	90.45%
Cortisporin Otic Soln., 10 ml	16.04	1.55	90.33%
Cortisporin Otic Susp., 10 ml	16.04	1.55	90.33%
Calan 120 mg tabs, 100	53.48	5.25	90.18%
Calan 120 mg tabs, 500	256.68	25.20	90.18%
Isordil Titradose 40 mg, 100	41.08	4.10	89.92%
Soma Compound, 500	403.96	47.00	88.36%
Bactrim Ped. Suspension, 16 oz	36.18	3.70	89.77%
Neosporin Ophth. Soln., 10 ml	12.19	1.29	89.42%
[illegible] 5 mg tabs, 100	25.92	2.80	89.20%
Erymax Topical Soln., 2 oz	15.88	1.75	88.98%
Albalon-A Liquifilm, 15 ml	11.31	1.25	88.95%
Chloroptic Ophth. Soln., 7.5 ml	11.25	1.25	88.89%
Emol lotion, 4 oz	11.25	1.25	88.89%
Bleph-10 Ophth. Soln., 5 ml	10.94	1.25	88.57%
Tolinase 500 mg tabs, 100	44.45	5.10	88.53%
Pred-Mild 0.12% O.S., 5 ml	$10.89	$1.25	$88.52%
Soma Compound, 100	100.00	11.55	88.45%
Pilocar 1% Ophth. Soln., 15 ml	7.92	0.92	88.38%
Depakene 250 mg caps, 100	77.35	9.35	87.91%
Blephamide Ophth. Susp., 5 ml	12.40	1.50	87.90%
Demulen 1/35 28, 6 x 28	121.66	15.00	87.67%
FML Liquifilm, 5 ml	11.88	1.50	87.37%
Depakene syrup, 16 oz	77.95	9.95	87.24%
Septra Suspension Grape, 16 oz	33.38	4.25	87.27%
Pred-Mild 0.12% O.S., 10 ml	15.19	1.95	87.16%
Pred Forte Ophth. Soln., 5 ml	11.55	1.50	87.01%
Slo-Bid Gyrocaps 125 mg, 100	23.77	3.15	86.75%
Blephamide Ophth. Oint., 3.5 gm	11.48	1.55	86.50%
Dolobid 250 mg tabs, 100	39.12	5.25	86.58%
Tolinase 250 mg tabs, 100	55.17	7.45	86.50%
Ery-Tab 333 mg tabs, 100	34.97	4.78	86.33%
[illegible] SR caps, 500	237.60	32.50	86.32%
Dolobid 500 mg tabs, 100	30.60	4.25	86.11%
Dolobid 500 mg tabs, 500	145.20	20.19	86.10%
Vi-Daylin w/Iron Drops, 50 ml	8.03	1.13	85.93%
Calan 40 mg tabs, 100	27.58	3.90	85.87%
Ery-Tab 333 mg tabs, 500	164.12	23.70	85.69%
E-Pilo 4 Ophth. Soln., 10 ml	12.66	1.82	85.62%
Trilisate 1000 mg tabs, 60	42.76	6.15	85.62%
[illegible] 20 mg tabs, 100	37.23	5.39	85.52%
Ery-Tab 250 mg tabs, 100	23.75	3.51	85.22%
Blephamide Ophth. Soln., 10 ml	16.36	2.45	85.07%
Ery-Tab 250 mg tabs, 500	112.01	17.43	84.44%
Demulen 1/50 28, 6 x 28	135.52	21.00	84.50%
E-Pilo 6 Ophth. Soln., 10 ml	13.08	2.03	84.48%
Vi-Daylin/F ADC Drops, 50 ml	8.27	1.29	84.40%
Pilocar 2% Ophth. Soln., 15 ml	7.92	1.25	84.22%
Kaon-Cl 10, 500	94.04	15.00	84.05%
Theo-Dur 200 mg tabs, 100	20.32	3.30	83.76%
Hytone 1% cream/oint., 1 oz	5.95	0.99	83.36%
Slo-Bid Gyrocaps 75 mg, 100	17.36	2.90	83.29%
FML Liquifilm, 10 ml	17.58	2.95	83.22%
Theo-Dur 300 mg tabs, 100	21.08	4.05	83.13%
Hytone 2.5% cream, 1 oz	10.20	1.75	82.84%
Stuartnatal 1+1, 100	16.74	2.87	82.86%
Slo-Bid Gyrocaps 50 mg, 100	15.73	2.70	82.84%
Vi-Daylin/F drops, 50 ml	9.03	1.55	82.83%
Theo-24 caps 300 mg, 100	30.47	5.31	82.57%
[illegible] 1/1, 28	47.89	8.40	82.46%
Pred Forte Ophth. Soln., 10 ml	16.81	2.95	82.24%
[illegible] 333 mg, 100	64.30	11.45	82.19%
Slo-Bid Gyrocaps 300 mg, 100	34.07	6.10	82.07%
Vi-Daylin Drops, 50 ml	8.03	1.44	82.07%
Theo-Dur Sprinkle 125 mg, 100	16.68	3.00	82.01%
Slo-Bid Gyrocaps 300 mg, 1000	333.75	60.00	82.00%

Source: MediSpan Prescription Pricing Guide and Pharma invoices, out of a sample of 500 branded drug products

EXHIBIT C

Discounting Across Pharmaceutical Distribution Channels

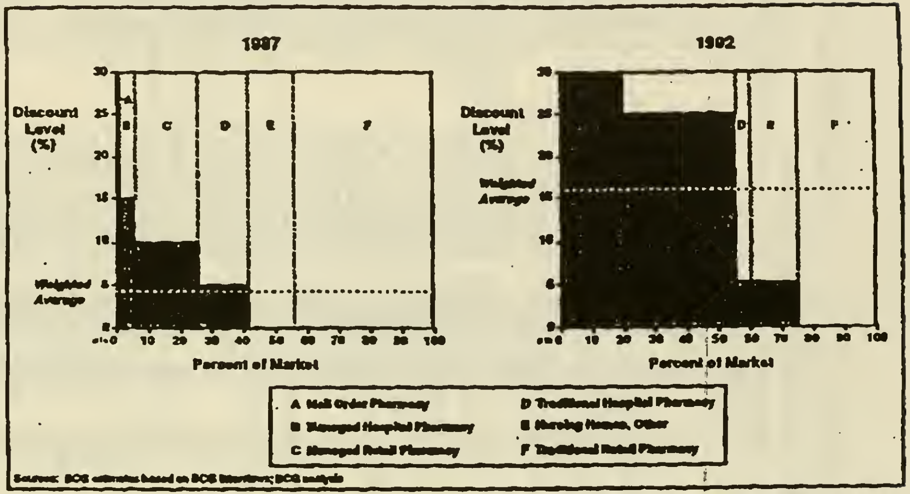

Figure 1-3: An estimation of discount activity in the distribution channels for brand name and generic pharmaceuticals indicates that manufacturer-level discounting has increased significantly in recent years, from 4 percent in 1987 to 16 percent in 1992. Not only the level of discounting, but also the portion of the market receiving deeper discounts, has increased.

JURY TRIAL DEMAND

Plaintiff respectfully demands a trial by jury on all issues so triable.

DATED: August 11, 1993

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Freedom of Choice

State By State

Twenty-three states have freedom of choice laws, 10 have legislation pending, and 17 have none at all. Here is a state-by-state review.

Alabama	Yes. Law enacted as part of insurance code. Carriers cannot restrict consumer choice of pharmacy.
Alaska	No.
Arizona	No.
Arkansas	Yes. Carriers cannot restrict consumer choice of pharmacy. However, HMOs are exempted.
California	No.
Colorado	No.
Connecticut	Yes. Enacted as part of insurance code. Carriers cannot restrict consumer choice of pharmacy; however, HMOs are exempted. Indemnity plans and HMOs cannot require the use of mail order.
Delaware	No.
Florida	Yes. Enacted as part of state health care reform package. Carriers cannot restrict consumer choice of pharmacy.
Georgia	Yes. Law enacted as part of insurance code. Use of mail order cannot be required, and carriers may not restrict consumer choice of pharmacy. Companies using mail order plans may not impose discriminatory copays.
Hawaii	No.
Idaho	Yes. Enacted as part of insurance code. Carriers may not restrict consumer choice of pharmacy. Exclusive use of mail order and discriminatory copays cannot be imposed.
Illinois	No.
Indiana	No.
Iowa	Yes. Enacted as part of insurance code. Exclusive use of mail order plans cannot be imposed.
Kansas	No.
Kentucky	No.
Louisiana	Yes. Enacted as part of insurance code. Carriers may not require use of mail order plans, and cannot impose discriminatory copays.
Maine	Yes. Carriers cannot restrict choice of pharmacy; however, PPOs and the state's Drugs for the Elderly program are exempted.
Maryland	Yes. Enacted as part of insurance code. Carriers may not impose discriminatory mail order copays.
Massachusetts	Pending. Legislation would prohibit restricting consumer choice of pharmacy; however, HMOs with in-house pharmacies would be exempt.
Michigan	Pending. Legislation would prohibit restricting consumer choice of pharmacy and use of discriminatory copays or deductibles.
Minnesota	No.
Mississippi	No.
Missouri	Yes. Carriers cannot restrict consumer choice of pharmacy. Exclusive use of mail order cannot be required.
Montana	Yes. Enacted as part of the insurance code. Carriers cannot restrict consumer choice of pharmacy.
Nebraska	Yes. A limited law prohibits carriers from requiring exclusive use of mail order. Pending legislation would prohibit discriminatory copays.
Nevada	No.
New Hampshire	Yes. HMOs cannot restrict consumer choice of pharmacy.
New Jersey	Pending. Legislation would prohibit restricting consumer choice of pharmacy.
New Mexico	No.
New York	Pending. Legislation would prohibit closed networks and mandatory use of mail order.
North Carolina	Pending. Legislation would prohibit restricting consumer choice of pharmacy.
North Dakota	Yes. Enacted as part of insurance code. Carriers cannot restrict consumer choice of pharmacy.
Ohio	No.
Oklahoma	Pending. Legislation would prohibit restricting consumer choice of pharmacy and mandatory use of mail order.
Oregon	Pending. Legislation would prohibit all providers, except HMOs with in-house pharmacies, from restricting consumer choice of pharmacy.
Pennsylvania	Pending. Legislation would prohibit restricting consumer choice of pharmacy and use of discriminatory copays.
Rhode Island	Yes. A limited law says that companies offering mail order must give patients the right to use local pharmacies.
South Carolina	Pending. Legislation would prohibit carriers from restricting consumer choice of pharmacy.
South Dakota	Yes. Carriers cannot restrict consumer choice.
Tennessee	Yes. Enacted as part of insurance code. Carriers who offer mail order cannot restrict consumer choice.
Texas	Yes. Law prohibiting restriction of consumer choice of pharmacy expires in July; pending legislation would continue freedom of choice.
Utah	Yes. Carriers may not require use of an out-of-state pharmacy.
Vermont	No.
Virginia	Yes. PPOs cannot restrict consumer choice of pharmacy. However, the law was recently ruled constitutional by the state Supreme Court.
Washington	Pending. Legislation would prohibit carriers from restricting consumer choice of pharmacy.
West Virginia	No.
Wisconsin	Yes. Enacted as part of insurance code. Carriers cannot restrict consumer choice of pharmacy; carriers offering mail order cannot impose discriminatory copays or deductibles, and cannot mandate exclusive use of mail order. HMOs with in-house pharmacies are exempt.
Wyoming	Yes. PPOs cannot restrict consumer choice of pharmacy.

SELECTED PRICE COMPARISONS

Manufacturer	Product	Quantity	Discounted price to non-community pharmacies such as HMOs, hospitals, clinics, nursing homes & mail-order businesses	Price to Community Pharmacies	Premium Paid By Community Pharmacies
Ciba-Geigy	Transderm-Nitro (Cardiac)	30 Patches	$ 8.40	$ 39.89	375%
Glaxo	Ventolin 4mg (Respiratory)	500 Tablets	63.84	183.71	188%
Searle	Calan 40mg (Cardiac)	100 Tablets	3.90	22.91	487%
Wyeth	Inderal 60mg (Cardiac)	100 Tablets	4.12	48.31	1073%
SmithKline	Eskalith CR 450mg (Lithium)	100 Capsules	17.18	23.02	34%
Schering-Plough	K-Dur 20meq. (Potassium)	100 Capsules	2.03	27.31	1245%

10/14/93

GAO United States
General Accounting Office
Washington, D.C. 20548

AUG 06 '90

Human Resources Division

August 2, 1990

The Honorable Jack Brooks
Chairman, Committee on the Judiciary
United States House of Representatives

Dear Mr. Chairman:

You requested GAO to study the type, prevalence, and impact of multi-tiered pricing practices for prescription drugs of certain pharmaceutical manufacturers. Such practices result in various types of customers (hospitals, health maintenance organizations, retail pharmacies) paying different prices for the same drug. During discussions with Committee staff we agreed to concentrate our efforts on obtaining prescription drug pricing information by customer type.

During the course of our work we contacted 11 manufacturers of prescription drugs (see enclosure). These manufacturers accounted for 8 of the leading 10 and 16 of the leading 30 prescription drugs sold in the United States during 1989. All eleven manufacturers denied our request for prescription drug pricing data. Company officials were concerned about disclosing information which they consider proprietary. Because the manufacturers would not provide us the pricing data needed to answer your request we have agreed with members of your staff to discontinue our efforts.

In addition to the manufacturers, we also requested drug pricing data from prescription drug wholesalers. However, due to clauses in their contracts with manufacturers that prohibited disclosing pricing data to third parties, the wholesalers were prevented from voluntarily releasing pricing data to us.

If we can be of any other assistance in this matter, please ask.

Sincerely Yours,

Mark V. Nadel

Mark V. Nadel
Associate Director for National
and Public Health Issues

Enclosure

ENCLOSURE

LIST OF THE PRESCRIPTION DRUG
MANUFACTURERS GAO CONTACTED

American Home Products Corporation

Burroughs Wellcome Co.

CIBA-GEIGY Corporation Pharmaceutical Division

Glaxo Inc.

ICI Pharmaceutical Group

Marion Laboratories, Inc.

Merrell Dow Pharmaceutical Inc.

Parke-Davis

Pfizer Inc.

Smith Kline & French Laboratories

The Upjohn Company

ONE HUNDRED FIRST CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

2137 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6216

June 22, 1989

Honorable Charles A. Bowsher
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear General:

I am writing to request that the GAO immediately conduct a study into the type and prevalence of "multi-tier" pricing practices by certain pharmaceutical manufacturers. Such pricing practices may be violative of the anti-discrimination provisions of the Robinson-Patman Act.

Increasingly, I and other Members of this Committee have received complaints from retail pharmacists from around the country that drug companies are charging widely disparate prices to different "retailers" for the same class of prescription drugs. The pharmacists contend that such conduct is not protected by any of the enumerated exceptions to the Robinson-Patman's ban on discriminatory pricing.

Of particular concern is the charge that manufacturers are bending the "classes of trade" concept of the Act to their own purposes so as to "technically" avoid antitrust violations. Under the Act, manufacturers are required to sell goods at the same price to all customers within the same "class of trade," but are permitted to charge differently to separate classes of trade. Thus, the Act would permit a wholesaler, which performs different services than a retailer, to purchase goods at a price different than that offered a retailer. The problem raised is whether such "classes of trade" are truly distinct or whether they are spurious classifications that mask prohibited discrimination. The growth "repackagers," who often sell drugs to physicians for subsequent in-house dispensing to patients, has recently been a focus of concern in the area of discriminatory pricing practices of prescription drugs. Other groups alleged to have received preferential pricing treatment from pharmaceutical companies include mail order firms, and for-profit pharmacies connected with HMOs, hospitals and nursing homes.

From a consumer standpoint, it is essential that the Committee have information as to whether the alleged multi-tier pricing activity has the effect of penalizing so-called "unprotected" patients (those not coming under the umbrella of medical provider groups such as HMOs) by having them offset, through higher prices, the savings received by recipients of "managed health care." Nowhere in the Act is the prohibition against discrimination dependent on the status or affiliation of a particular purchaser.

Given these concerns, I request the GAO to investigate the extent and incidence of multi-tier pricing practices in the current economy of medical care provision. In conducting this study, I want the GAO to identify with specificity the different types of multi-tier practices that currently exist, with particular focus on how such practices may attempt to circumvent the "classes of trade" concept in the Robinson-Patman Act. Attention should also be directed to the type of contractual arrangements that may have been "extracted" by manufacturers from retail pharmacists. Additionally, I want the GAO to identify those "unprotected" groups which may be subject to higher charges as a result of lower prices charged to protected members of managed health care and estimate the amount of additional costs incurred by unprotected consumers as a result of disparate pricing by drug companies. The so-called protected beneficiaries of managed health care should also be identified. Finally, I request that the GAO develop estimates of the economic consequences of multi-tier pricing upon the national cost of health care, particularly as to its effects on various classes of consumers (e.g., children, the elderly, and patients with chronic and non-chronic illnesses), as well as its effects on the cost of government-provided health care (e.g., Medicare, Medicaid, payments to government workers, retirees, and military dependents). In this same regard, information has been submitted to the Committee indicating that in the past 10 years, manufacturers have raised their drug prices by an average of 311 percent, while during the same period, retail prescription prices have risen an average of 251 percent. I would want to know what the projected consequences may be for consumers if this pattern continues in the next 5 years.

Because of the number and intensity of complaints received, I would like a complete response from the General Accounting Office within 90 days so that the Subcommittee on Economic and Commercial Law, which I chair, can promptly determine whether further legislative oversight or action is necessary.

With best wishes.

Sincerely,

JACK BROOKS
Chairman

MR. BROOKS' QUESTION FOR THE RECORD FOR MR. VAGLEY

Question: As you know, H.R. 9 would remove the antitrust exemption only as to four specified offenses: price fixing, market allocation, unlawful tying, and monopolization. We added this limitation to the bill in 1988, in response to the insurance industry requests for more certainty. Could you please explain why, in recent discussions, the AIA appears not to favor this approach?

AIA has difficulties with the structure of H.R. 9 for two reasons. First, H.R. 9 would require that every antitrust action against insurers be brought as a "per se" violation of the Sherman Act, thereby precluding the courts' use of the more flexible "rule of reason" analysis and denying insurers an opportunity to justify any alleged restraint as being reasonable under the circumstances. This problem arises because the bill lists four categories of per se antitrust offenses for which the insurance industry would be liable -- price fixing, market allocation, unlawful tying, and monopolization. Thus, the only way to bring an antitrust action against insurers is to bring it as a "per se" case.

While we understand that the intent of H.R. 9's structure was to be a limited repeal or modification of McCarran, the result, though unintended, is just the opposite by repealing McCarran and subjecting insurers to greater antitrust liability than any other industry. Because virtually any antitrust case can be characterized as one of H.R. 9's four per se violations, courts will be inclined to apply the rigid "per se" test rather than to dismiss an action, which would be the only other option available to the court.

Second, H.R. 9 repeals the state action doctrine with regard to the "business of insurance." This is true because the antitrust laws would apply to the "business of insurance" regardless of whether that business is or is not regulated by state law. Under H.R. 9, federal antitrust law would apply to the "business of insurance" to the extent that it is not regulated by state law or that it involves one of the four enumerated "per se" categories of conduct. Thus, for activities falling into those categories, H.R. 9 would apply federal antitrust law even if the activity is regulated under state law. If the antitrust law is applied to conduct regardless of state regulation, then the state action doctrine can have no application. In other words, that doctrine would be effectively repealed as to the insurance industry alone. This concern is shared by the Department of Justice. Its November 18, 1991 letter to Congressman Brooks stated in pertinent part:

> The Department is concerned that the language of H.R. 9 is ambiguous as to whether the bill would effectively preempt state regulation that would constitute state action

> exempt from the operation of the antitrust laws under established judicial precedent. . . . The Committee's [on the Judiciary] report addressed the ambiguity regarding the scope of state action protection in the section-by-section analysis accompanying the bill. . . .
>
> We believe attempts to deal with the state action/preemption issue by means of legislative history are inadequate. Courts are not required to consult legislative histories in all instances, and will do so only if there is ambiguity on the face of the statute. While we believe such ambiguity exists, it is not so apparent as to ensure that the intent of Congress will necessarily be discerned by courts by resort to legislative history. <u>Thus, we believe that any ambiguity with respect to the application of the state action doctrine to the business of insurance must be eliminated from the bill itself</u>. [Emphasis added; footnote omitted.]

The Justice Department expressed similar reservations about H.R. 9's predecessor, H.R. 2727, in a July 20, 1988 letter to Congressman Hamilton Fish, Jr. AIA believes that true modification of McCarran that eliminates antitrust protection except for specifically enumerated safe harbors governing essential collective activities is possible, but we do not believe that it can be achieved within the current structure of H.R. 9.

REPUBLICAN MEMBERS QUESTIONS FOR THE RECORD

Questions for:

Robert E. Vagley, President, American Insurance Association

(1) Because your Association is comprised of the larger property/casualty companies, is it correct to assume that your members have less need for the jointly collected and shared actuarial data than other property/casualty companies? Are some of your members in a position where they can rely on their own actuarial data -- that is, data which they themselves generate?

The American Insurance Association is comprised of both large and small property and casualty insurers. In the context of the H.R. 9 debate, market share in a particular line for a specific geographic area is far more important than the overall size of the insurer. Moreover, insurers, regardless of size, use shared actuarial data to augment their claims base. The availability of such reliable actuarial data is invaluable in the development of sound actuarial analyses. Access to industry-wide actuarial data also enables companies, regardless of size, to develop a suitable information base to enable them to enter new geographic markets or lines of business with greater confidence, thereby promoting competition. Larger insurers typically employ their own actuaries to develop critical actuarial data based on their company's own experience. However, this does not preclude the need for reliable industry-wide data, which can be used to improve the statistical accuracy of their own actuarial analyses.

(2) Some have alleged that the AIA position on the McCarran-Ferguson Act reflects the fact that your members would likely benefit (i.e., an increased market share) from any consolidation or downsizing in the property/casualty industry. How do you respond to this argument?

AIA's only goal on McCarran-Ferguson is to end the acrimonious debate on the law in a way which preserves protection for critical industry collective activities. To achieve that goal, AIA has proposed a modification of McCarran-Ferguson that would establish safe harbors for four essential business activities: (1) data collection and analysis; (2) standardized forms; (3) joint underwriting and pooling; and (4) fire inspections. For all other activities, all federal antitrust principles (except for the Federal Trade Commission Act) would fully apply. These safe harbors are intended to protect the essential collective activities involving both large and small property and casualty insurers, while at the same time responding to the legitimate concerns of the current law's critics. We do not believe that our proposed legislation would have any negative effect on the market success of individual companies.

(3) Could you describe the "standardization of forms" issue that is presented by the language contained in H.R. 9? How would AIA propose to resolve this issue in the legislative context?

H.R. 9 provides no antitrust protection for the standardization of forms. By contrast, AIA's proposed modification would establish a specific McCarran safe harbor for collective activity by insurers and insurer organizations in developing, preparing, and using standardized forms. The availability of standardized forms helps consumers comparison shop; eases the regulatory burden on state insurance departments; and helps establish a common understanding among insurers, the courts, regulators, and the public about what policies do and do not cover. Moreover, without standardized forms, it would be virtually impossible to obtain useful actuarial data about claims and costs, thereby substantially increasing the risk that pricing would be inaccurate.

(4) Could you also discuss the concept of "risk pooling" and make suggestions to the Subcommittee as to how it should be dealt with in this legislation?

AIA's proposal includes a safe harbor covering joint underwriting and pooling for the purpose of spreading risk or sharing risks. The industry participates in a wide variety of voluntary risk pooling and reinsurance arrangements. These are critical to ensure adequate insurance capacity for our Nation's growing economy and to facilitate the spreading of property and casualty insurance risks within the United States and worldwide. For example, joint underwriting and pooling arrangements are used to cover airport, aviation, and space risks; large industrial or property risks; oil, gas, or chemical risks; atomic or nuclear energy risks; inland and ocean marine risks; natural disasters; occupational accidents or injuries; risks arising from the transportation of currencies, securities or other valuables; risks relating to foreign commercial activities undertaken in cooperation with the United States Export-Import Bank; and war or other high limit risks. In many states, insurers are also required to participate in joint underwriting or pooling arrangements to guarantee insurance coverage for high risk insureds or activities. Essential property insurance in urban areas provided through Fair Access to Insurance Requirements ("FAIR") plans, and automobile and worker's compensation assigned risk plans are examples of such mandated pooling arrangements.

Appendix 2.—Material Submitted for the Hearing Record

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION
TO THE ECONOMIC AND COMMERCIAL LAW SUBCOMMITTEE
OF THE HOUSE JUDICIARY COMMITTEE
REGARDING H.R. 9, A BILL
TO MODIFY THE ANTITRUST EXEMPTION
APPLICABLE TO THE BUSINESS OF INSURANCE

July 29, 1993

This statement is filed on behalf of the American Farm Bureau Federation, our nation's largest general farm organization which represents over 4 million member families in all 50 states and Puerto Rico.

We appreciate this opportunity to present our views on H.R. 9, a bill to modify the antitrust exemption applicable to the business of insurance.

We have long contended that one of the strengths of the Farm Bureau has been--and is--the grassroots system by which farmers and ranchers develop their points of view on many local, state and national issues. Their policies are eventually compiled in a set of resolutions adopted by the elected voting delegates of the member state Farm Bureaus at our annual meeting.

At our 74th annual meeting held earlier this year in Anaheim, California, the American Farm Bureau Federation adopted a very specific resolution which is directly applicable and relevant to H.R. 9. It states:

> "We strongly oppose repeal or amendment of the McCarran-Ferguson Act. We favor state regulation of insurance companies."

Mr. Chairman, our organization is primarily an agricultural federation that provides a variety of services to its members. In many cases, these services include a variety of insurance products.

The various Farm Bureau affiliated insurance companies were originally started by the state Farm Bureau federations to serve the insurance needs of farmer members who had difficulty buying insurance because of the unprotected nature of their property. Because each state has its own Farm Bureau organization or federation, each federation started its own company (or affiliated with an existing Farm Bureau insurance company in a neighboring state). Since each of the Farm Bureau insurance companies was started for the purpose of serving a particular federation's members, these companies sell insurance for the most part in only the state of its parent federation, and sell only to its parents' members.

Since the Farm Bureau insurance companies were formed, however, it is no longer difficult for farmers to purchase insurance. In fact, because of McCarran-Ferguson, which promotes competition, and because of the success of the Farm Bureau insurance companies in serving farmers' insurance needs, there are now many local and regional insurance companies willing to sell insurance to farmers.

Without McCarran-Ferguson and the ability of these small, local and regional companies to share loss data, there would still be a limited market for farm insurance, or the market would be served by a few large national stock insurance companies. Unlike the limited availability of insurance for farmers that caused the Farm Bureau federations to start their own insurance companies, there is now unlimited availability of insurance for farmers from many small, local and regional insurance companies, including the Farm Bureau insurance companies. Take away McCarran-Ferguson which promotes competition and you very well may yank the rug from undemeath these small, local and regional companies. The large national stock companies would then fill the void resulting in a much less competitive environment. It is interesting to note that currently there is not a single national stock company with any substantial share of the farm insurance market.

The legal underpinning for the sound and fair delivery of the entire insurance industry in this country has been the McCarran-Ferguson Act of 1945.
We feel this statue has been working in the public interest and should continue to work in the public interest.

For these reasons, we respectfully continue to oppose the enactment of the bill H.R. 9.

AUG 05 1993

AMERICAN
BANKERS
ASSOCIATION

1120 Connecticut Avenue, N.W.
Washington, D.C.
20036

DIRECTOR AND COUNSEL
OPERATIONS AND RETAIL
BANKING
Philip Corwin
202/663-5347

August 4, 1993

The Honorable Jack Brooks
Chairman
House Judiciary Committee

Dear Chairman Brooks:

On behalf of the American Bankers Association (ABA), I am pleased to advise you that ABA remains in full support of your legislation, H.R. 9, the "Insurance Competitive Pricing Act of 1993". The ABA is the national trade and professional association for America's commercial banks, from the smallest to the largest. ABA members represent about 90 percent of the industry's total assets. Approximately 94 percent of ABA members are community banks with assets less than $500 million.

Competition remains the name of the game in today's financial services industry. American financial service companies must be fully competitive in a global marketplace, and American consumers deserve the benefits of open competition. The insurance industry can no longer justify its broad exemption from the antitrust laws which constitute the "rules of the game" for all other American businesses. H.R. 9 would ensure that insurers begin to play by those rules by prohibiting the most significant violations of antitrust laws now possible under McCarren-Ferguson.

Banks and insurers compete directly in a growing range of financial services activities. And banks and insurers are strikingly similar in their basic business functions. In order to ensure the competition between the two industries is fair, insurers should be brought within the scope of the antitrust laws which already apply to banks, particularly given the major differences in regulatory and competitive structure between the two industries.

No portion of the financial services industry should be permitted to collectively determine the products it sells and its prices. Given the significant questions which have been raised by recent Congressional inquiries into the adequacy of the state-by-state regulation of the insurance industry, particularly in regard to ensuring solvency, ABA believes that it would be beneficial if the insurance industry was subjected to fuller competitive forces.

The difference in antitrust treatment between banks and insurers is striking, since

both types of financial intermediaries perform many similar business functions. Banks are subject to both the Clayton and Sherman Acts, and the banking laws contain additional rules barring practices which would not constitute antitrust violations. Further, the Justice Department is involved in reviewing every bank merger application. Price fixing conducted by banks constitutes a per se violation of the Sherman Act. And the antitying provisions of the Bank Holding Company Act (BHC), which apply to all banks and bank holding companies, prohibit any extension of credit or provision of services by a bank on condition that customers obtain additional services. Penalties for violation of these BHC Act provisions include fines, treble damages, and injunctive relief; these provisions are stricter than those in antitrust law. The various consumer credit laws also prohibit coercive tying arrangements, and the banking regulators are required to adopt enforcement regulations which are substantially similar to those issued by the Federal Trade Commission.

To sum up, both the regular antitrust laws and additional bank-specific laws prohibit price fixing, territorial allocation among competitors, coercive tying, and monopolization by banks. Thus, all the anticompetitive practices which H.R. 9 would prohibit for insurers are already illegal for the banking industry. In addition, FTC-derived rules apply to many bank lending activities. If H.R. 9 was the law today, insurers would still be subject to less rigorous antitrust rules than banks are.

Given that thousands of small community banks throughout the United States are able to compete and profit subject to these rules to assure competition, ABA believes that well-managed small insurance companies would similarly have no significant difficultly surviving in the competitive environment envisioned under H.R. 9. Passage of H.R. 9 would not only lead to greater competition within the insurance industry, but also to fairer competition between the insurance industry and other financial services providers.

In recent years banks have expanded their ability to sell various types of insurance products, despite the continued hostility of many elements within the insurance industry. Insurance groups opposed to bank entry into insurance make baseless allegations that such activity will lead to economic concentration and coercive tying activities. But the banking industry is already subject to the antitrust laws which prevent such abuses. Ironically, it is the insurance industry which does not want to be subject to these laws so that it may continue to engage in anticompetitive practices which are illegal for all other American businesses.

ABA believes that industry-specific antitrust exemptions are contrary to the basic premises of the antitrust laws, and that neither the public nor the insurance industry are well served by competitive framework which tolerates inefficiency and accepts ineffective regulation. We can understand that some insurers would prefer not to fully compete among themselves or to face new competition from banks. But Congress' job is to decide what policy would best benefit the overall public interest, not any particular private interest.

The financial services industry continues to undergo rapid evolution. ABA believes that insurers, which have always been "invisible bankers", and which today are openly providing bank-like products and services, no longer can justify or deserve a broad exemption from the antitrust laws. The enactment of H.R. 9 would greatly advance the goal of helping to assure that the American financial services industry evolves in a pro-competitive manner.

Again, ABA commends you and your Committee for your continued attention to this important issue. We are fully supportive of your efforts to enact H.R. 9.

Sincerely,

Philip S. Corwin

Philip S. Corwin

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